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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

AMERICAN DEPOSIT CORP. and BLACKFEET NATIONAL BANK,

Petitioners,

v.

JAMES W. SCHACHT, individually and as Acting Director of Insurance of the State of Illinois,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

No. 95-2462

AMERICAN DEPOSIT CORPORATION
and BLACKFEET NATIONAL BANK,

Plaintiffs-Appellants,

v.

JAMES W. SCHACHT, individually and as Acting Director of Insurance of the State of Illinois,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 95 C 207—**Edward A. Bobrick**, *Magistrate Judge.*

ARGUED JANUARY 12, 1996—DECIDED MAY 13, 1996

Before CUMMINGS, FLAUM, and DIANE P. WOOD, *Circuit Judges.*

CUMMINGS, *Circuit Judge.* The National Bank Act ("Bank Act") arguably permits a national bank to sell an innovative investment product known as the "Retirement CD." The Illinois Insurance Code ("Insurance Code"), however, prohibits selling this product without a certificate of authority from the Director of Insurance. Defendant Blackfeet National Bank ("Blackfeet") has no such certificate and sued for a declaration that the Illinois Insurance Code cannot stand in the face of the National Bank Act. The district

court concluded that the sale of the Retirement CD was the "business of insurance" within the meaning of the McCarran-Ferguson Act, which reverses the rule of federal preemption, and thus held that the Illinois Insurance Code applied regardless of whether the sale of the Retirement CD was authorized by the National Bank Act. For the following reasons, we affirm that decision.

I.

The following facts are undisputed. Plaintiff American Deposit Corporation, of Pine, Colorado ("ADC") owns and licenses to banks an investment vehicle known as the Retirement CD. The Retirement CD is structured such that the purchaser qualifies for special tax treatment by the Internal Revenue Service. A customer first deposits money with an individual bank and selects a maturity date in the future (usually the customer's anticipated retirement date). Interest then accumulates on the deposits until the maturity date, at which time the depositor may withdraw in a lump sum up to two-thirds of the account balance, including the accrued interest. Thereafter, the customer receives the remainder of the account in periodic payments for the rest of his life—essentially a lifetime annuity. The amount of each payment is determined according to mortality tables and a guaranteed interest rate. The customer is assured of receiving the entire amount of the account balance regardless of his lifespan; if he dies prior to receiving that amount in monthly payments, the remainder of the account is paid in a lump sum to his estate or designated beneficiary.

Blackfeet is a small national bank located on the Blackfeet Indian Reservation in Browning, Montana and is a licensee of the Retirement CD. By late 1994, Blackfeet was offering the Retirement CD to investors across the country, although it had yet to accept a deposit from an Illinois resident. Defendant Schacht, on behalf of the State of Illinois, issued an order on December 9, 1994, directing Blackfeet to "immediately cease and desist any and

all practices which purport to offer [the Retirement CD] to residents of the State of Illinois." The basis for the order was that Blackfeet was engaging in the business of insurance without a certificate of authority to do so in violation of 215 ILCS 5/24. Plaintiffs concede that because of its lifetime monthly payments feature, the Retirement CD is essentially an annuity and that the Insurance Code includes "granting, purchasing or disposing of annuities" within the "life insurance" classification of the business of insurance. 215 ILCS 5/4(a). Section 5/24 of the Insurance Code dictates that "[n]o company shall transact any business of insurance until it has received a certificate of authority" from the Director of Insurance, which plaintiffs concede they do not have.

The Director of Insurance issues certificates of authority only to domestic, foreign, or alien companies. "Domestic companies" are those organized under the laws of the State of Illinois, 215 ILCS 5/2(f), "foreign companies" are those organized under the laws of any other state or territory of the United States, or the District of Columbia, 215 ILCS 5/2(g), and "alien companies" are those organized under the laws of a country other than the United States, 215 ILCS 5/2(h). Because Blackfeet is a national bank organized under the Bank Act, it does not qualify for certification as any of the above.[1] Additionally, 215 ILCS 5/111(c) dictates that companies which engage in other business in addition to the life insurance business—which, as a bank, Blackfeet obviously does—may not be certified. Therefore, Blackfeet is not permitted under the Insurance Code to sell and underwrite the Retirement CD in Illinois. The only way it could accomplish the sale in compliance with the Insurance Code would be to set up

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[1] The Insurance Code does allow a national bank located in a town of 5000 or less people—such as Blackfeet—to register with the director in order to transact insurance business in Illinois as an insurance *agent*, but does not allow such a bank to act as an underwriter of the policies. 215 ILCS 5/499.1(a) & (e).

a subsidiary specifically for that purpose, which could then be issued a certificate of authority.

Blackfeet brought suit against Schacht for a declaration that the sale of the Retirement CD is not subject to regulation by the State of Illinois. Blackfeet argues that the Bank Act, through the express authority to receive deposits, 12 U.S.C. § 24 (Seventh), and to enter into contracts, 12 U.S.C. § 24 (Third), authorizes the sale of the Retirement CD. We will assume, arguendo, that it does.[2] Magistrate Judge Bobrick granted summary judgement to Schacht, concluding that "the nature of the Retirement CD makes it an appropriate subject for regulation as an insurance product because it entails an insurance or mortality risk and a guaranteed return."

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[2] In support of their claim that the Bank Act authorizes the sale of the Retirement CD, plaintiffs offer a letter from the Office of the Comptroller of the Currency ("OCC"), advising Blackfeet that the OCC "had no objection if [Blackfeet] proceeds with its plans to market and offer the Retirement CD." [Def. App. p. 33]. Importantly, however, the OCC specifically noted that "state regulatory officials may conclude that state insurance laws apply to the Retirement CD." [Doc. 36, Ex. 8, p.2]. Moreover, in a letter responding to concern expressed by John D. Dingell, Chairman of the United States House of Representatives Committee on Energy and Commerce, over whether national banks underwriting the Retirement CD would be required to comply with state insurance laws, the OCC wrote:

> In concluding that the Retirement CD represents a bank authorized product, *we did not need to address the question of whether the bank is authorized to sell or underwrite annuities, or whether annuities are insurance products*. . . . State regulatory officials may conclude that the state insurance laws also apply to the Retirement CD or any other activity which we interpret as being authorized by the National Bank Act. Such a conclusion however, does not affect our interpretation of the Act. *A state's insurance laws and the National Bank Act are different laws with different purposes behind them.* [App. 200] (emphasis added).

II.

We review the grant of a motion for summary judgment *de novo*, drawing all reasonable inferences in favor of the non-moving party. *Smith v. Shawnee Library Sys.*, 60 F.3d 317, 320 (7th Cir. 1995).

The tension in this case comes from an apparent overlap between activities arguably authorized by the Bank Act and activities that individual states have a legitimate interest in regulating. If we assume that Blackfeet is authorized to sell the Retirement CD under the Bank Act, the pertinent question is whether the Insurance Code can nonetheless prohibit the sale. It is well settled that a federal law preempts a conflicting state law under the Supremacy Clause of Article VI of the Constitution, and the Bank Act is no exception. See, *e.g.*, *Barnett Bank of Marion County, N.A. v. Nelson*, 116 S. Ct. 1103 (holding that a provision of the Bank Act which allows national banks located in towns with populations of fewer than 5000 people to act as insurance agents preempts contrary state law); *Franklin Nat'l Bank v. New York*, 347 U.S. 373 (striking down an effort to apply state Saturday closing laws to national banks); *Easton v. Iowa*, 188 U.S. 220 (striking down state regulation of the circumstances in which a national bank can accept deposits). Thus under ordinary preemption rules, the provisions of the Bank Act would trump contrary Illinois law.

However, with regard to the "business of insurance," the McCarran-Ferguson Act "overturn[ed] the normal legal rules of preemption" by imposing a rule "that state laws enacted for the purpose of regulating the business of insurance do not yield to conflicting federal statutes unless the federal statute specifically provides otherwise." *U.S. Dep't of Treasury v. Fabe*, 113 S. Ct. 2202, 2211. Specifically, Section 1012 of the McCarran-Ferguson Act provides:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the

> several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance . . . .

Thus to decide whether the Insurance Code may stand in the face of the Bank Act we must resolve three issues: (1) whether the pertinent sections of the Insurance Code were enacted "for the purpose of regulating the business of insurance"; (2) whether the Retirement CD is properly considered "the business of insurance"; and (3) whether the pertinent provisions of the Bank Act "specifically relate to the business of insurance." *Id.*

A.

In *SEC v. National Sec., Inc.*, 393 U.S. 453, the Court held that "statutes aimed at protecting or regulating th[e] relationship [between insurer and insured], directly or indirectly, are laws regulating the 'business of insurance.' " *Id.* at 460. The opinion emphasized that the focus of the McCarran-Ferguson Act is upon the relationship between insurance companies and their customers:

> The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. *Id.*

The Court stated that the "broad category of laws enacted 'for the purpose of regulating the business of insurance' consists of laws that possess the 'end, intention,

or aim' of adjusting, managing, or controlling the business of insurance." *Id.* (citing *Black's Law Dictionary* 1236, 1286 (6th ed. 1990)). Section 5/24 of the Insurance Code prohibits companies from selling any type of insurance without gaining prior approval of the Department of Insurance. The approval requirement is necessary for the State of Illinois to monitor and regulate the relationship between insurer and insured; without it, regulations that more directly concern the actual relationship between insurer and insured would be impossible to enforce. Furthermore, 215 ILCS 5/121-1 expressly states that the Illinois General Assembly enacted the certification requirement because it was "concerned with protection of residents of [Illinois] against acts by insurers not authorized to do an insurance business in [Illinois]." We conclude that Section 5/24 possesses the " 'end, intention, and aim' of adjusting, managing, or controlling the business of insurance," and was therefore enacted "for the purposes of regulating the business of insurance." *Id.* Thus the first prong of the test is satisfied.

B.

Having concluded that Section 5/24 was "enacted for the purpose of regulating the business of insurance," we must determine whether the sale of the Retirement CD is properly considered the "business of insurance." Section 5/4(a) expressly includes annuities in its definition of "life insurance," but we may not simply defer to that definition. *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 ("The meaning of 'insurance' . . . under the [McCarran-Ferguson Act] is a federal question."). Thus we must go further and examine whether the specific practice to which the Code would be applied—the sale of the Retirement CD—is properly considered the "business of insurance." See *Fabe*, 113 S. Ct. at 2212 (noting that an Ohio priority statute was the "business of insurance" to the extent that it regulated policyholders, but not to the extent that it furthered the interests of other creditors); *Merchants Home Delivery Serv., Inc. v. Reliance Group Holdings,*

Inc., 50 F.3d 1486, 1489 (9th Cir. 1995) ("The proper inquiry is whether . . . the specific practice being challenged under federal law is a part of the 'business of insurance.' ").

Plaintiffs initially cite *NationsBank of N.C. v. Variable Annuities Life Ins. Co.*, 115 S. Ct. 810, in claiming that the Supreme Court has already held that the Retirement CD, as an annuity, is not the "business of insurance." We think plaintiffs read too much into that case. In *NationsBank*, the Comptroller of the Currency had authorized a national bank to broker annuities as "an incidental powe[r] . . . necessary to carry on the business of banking." *Id.* at 814. In addition, the Comptroller had concluded that annuities were not "insurance" within the meaning of 15 U.S.C. § 92, which allows national banks doing business in towns of 5000 people or less to act as an agent for an insurance company. The Court held that the Comptroller's interpretations of the Bank Act were reasonable and thus were given controlling weight. *Id.* However, *NationsBank* is distinguishable from our situation. First, the holding was limited to the brokering, not underwriting, of annuities. *Id.* at 815 n.4 ("Assuring that the brokerage in question would not deviate from traditional bank practices, the Comptroller specified that NationsBank 'will act only as agent, . . . will not have a principal stake in annuity contracts and therefore will incur no interest rate or actuarial risks.' "). Second, the holding was limited to whether federal law precluded a national bank from brokering annuities, not whether a bank doing so—much less a bank underwriting annuities—would be subject to state regulation.[3] In fact, the Supreme Court expressly noted that "States generally classify an-

[3] By deferring to the Comptroller's view that the brokering of annuities was an incidental banking power, the Court never reached the question of whether Section 92, by negative implication, precludes national banks located in places more populous than 5000 from brokering insurance—the argument made by the Respondent in *NationsBank*.

nuities as insurance when defining the powers of . . . state insurance regulators." *Id.* at 815. Thus, *NationsBank* did not answer the question as plaintiffs suggest.

However, the Supreme Court has spoken on this issue and articulated a tripartite standard in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, and *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, to determine what constitutes the "business of insurance" for purposes of Section 1012(b) of the McCarran-Ferguson Act. Those criteria are: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 129.

We are aware that the Supreme Court, in distinguishing the state law at issue in *U.S. Dep't of Treasury v. Fabe* from those at issue in *Royal Drug* and *Pireno*, recently noted that those cases involved determinations of whether certain activities were the "business of insurance" for purposes of the second clause of Section 1012(b), which exempts the "business of insurance" from antitrust laws, not determinations of whether laws were "enacted for the purposes of regulating the business of insurance" for purposes of the first clause of Section 1012(b):

> Both *Royal Drug* and *Pireno*, moreover, involved the scope of the antitrust immunity located in the *second* clause of § [101]2(b). We deal here with the *first* clause, which is not so narrowly circumscribed. The language of § [101]2(b) is unambiguous: the first clause commits laws "enacted . . . for the purpose of regulating the business of insurance" to the States, while the second clause exempts only "the business of insurance" itself from antitrust laws. To equate laws "enacted . . . for the purpose of regulating the business of insurance" with "the business of insurance" itself, as petitioner urges us to do, would be to read words out of the statute. This we refuse to do. *Fabe*, 113 S. Ct. at 2209-2210.

However, we do not interpret this language to mean that it is inappropriate to utilize the criteria announced in *Royal Drug* and *Pireno* in cases involving the first clause of Section 1012(b). Rather, the Court merely noted that one cannot answer the question of whether a state law was "enacted for the purposes of regulating the business of insurance" merely by reference to the *Royal Drug* and *Pireno* criteria. As the Sixth Circuit recently recognized,

> If . . . the issue arises of whether a particular activity is part of the "business of insurance," the *Pireno* criteria apply. See *Fabe*, 113 S. Ct. at 2208 (noting, in considering claim that arose under first clause of § 1012(b), that *Pireno* "identified the three criteria . . . that *are* relevant in determining what activities constitute the 'business of insurance.' ") (emphasis added). In short, the *Fabe* Court merely noted that the scope of the respective immunities created by the first and second clauses of § 1012(b) are different; it assuredly did not give "business of insurance" one meaning in the first clause and a different meaning in the second. *Owensboro Nat. Bank v. Stephens*, 44 F.3d 388 (6th Cir. 1994), certiorari denied, 116 S. Ct. 1350.

Because the situation facing us involves a determination of whether the sale of the Retirement CD is to be included within the "business of insurance," we shall apply the criteria announced in *Royal Drug* and *Pireno*.

The first and most important factor in determining whether a practice is the "business of insurance" is whether it spreads policyholder risk. The spreading and underwriting of a policyholder's risk are "indispensable characteristic[s] of insurance," *Pireno*, 458 U.S. at 127; *Royal Drug*, 440 U.S. at 212, and the legislative history of the McCarran-Ferguson Act "strongly suggest[s] that Congress understood the business of insurance to be the underwriting and spreading of risk." *Royal Drug*, 440 U.S. at 221; H.R. Rep. No. 873, 78th Cong., 1st Sess., 8-9 (1943) ("Insurance is the distribution of risk according

to hazard, experience, and the law of averages."). Essentially, lifetime annuities such as the Retirement CD are the "mirror image" of life insurance policies.[4] With life insurance, the issuing company gambles that the purchaser of the policy will not pass away sooner than predicted such that the company does not receive enough in premiums and interest to cover the policy's payout obligation; with lifetime annuities, the position is reversed and the company gambles that the annuitant will not survive longer than predicted such that the company will have to pay more than the amount invested by the annuitant

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[4] Plaintiffs cite numerous cases and treatises which have distinguished insurance and annuities. See, *e.g.*, *Helvering v. Le Gierse*, 312 U.S. 531 ("[A]nnuities and insurance are opposites; in combination the one neutralizes the risk customarily inherent in the other . . . insurance looks to longevity, annuity to transiency."); 3 C.J.S. *Annuities* § 3c ("An annuity contract is distinguished from an insurance contract in that insurance . . . is an agreement to . . . pay a specified sum on the death of the insured or his reaching a certain age, while an annuity is . . . an agreement to pay a specified sum to the annuitant annually during life."); 43 Am. Jur. 2d *Insurance* § 5 ("[A] company engaged merely in selling annuities does not conduct an insurance business."). Defendant and Amici, on the other hand, provide an equally lengthy list of treatises and cases stating that annuities *are* insurance. See, *e.g.*, *New York Life Ins. Co. v. Sullivan*, 192 A. 297 (N.H. 1937) (holding that annuities are insurance); *Mutual Ben. Life Ins. Co. v. Commonwealth*, 116 N.E. 469 (Mass. 1917) (same); A. Fingland Jack, *An Introduction to the History of Life Assurance* 165 (New York, E.P. Dutton & Co. 1912) ("As it exists in the present day . . . the [annuity] contract is certainly life insurance."); Solomon S. Huebner, *Life Insurance* 47, 58 (1915) (classifying annuities as a "leading group of life insurance"). The most we can conclude from these long lists of cases and treatises is that annuities are not *exactly* insurance policies, but that the two have multiple similarities. Thus courts and treatise writers have stated that the two products are different in some situations, and the same in others. Unfortunately, none of the cases or treatises authoritatively answers the question that we must decide: Whether annuities are properly considered "insurance" for the purposes of the McCarran-Ferguson Act and state regulation.

(plus interest). The element of mortality risk, however, is the same in both:

> Each issuer [of an annuity] assumes the risk of mortality from the moment the contract is issued. That risk is an actuarial prognostication that a certain number of annuitants will survive to specific ages. Even if a substantial number live beyond their predicted demise, the company issuing the annuity—whether it be fixed or variable—is obligated to make the annuity payments on the basis of the mortality prediction reflected in the contract. This is the mortality risk assumed [by the issuer]. *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 70.

See also *Associates In Adolescent Psychiatry v. Home Life*, 941 F.2d 561, 565 (7th Cir. 1991) ("Annuities sometimes contain an element of insurance: they may, for example, promise a monthly payment from retirement until death . . . [t]he seller then bears both investment and insurance risks."). That typical life insurance involves payment "upon" a death, while lifetime annuities involve payment "until" a death is a distinction without a difference: a company selling either the typical insurance policy or the lifetime annuity uses exactly the same actuarial tables to calculate its mortality risk and to set the price of its product.

Not all annuities have insurance characteristics, however. The Supreme Court has noted that " 'insurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts," *Variable Annuity Life Ins. Co.*, 359 U.S. at 71, and thus has held that variable annuities are not "insurance" for purposes of the Securities Act of 1933. *Id.* at 71-73. The Retirement CD is not a variable annuity. It offers a guaranteed payment to the annuitant for the rest of his life in a predetermined amount and also provides a guaranteed return of the total balance. Thus it involves both fundamental characteristics of insurance: a mortality risk and a guaranteed return. *Id.* at 71.

Plaintiffs argue that the Retirement CD does not satisfy the first criterion—spreading risk—by emphasizing that the spreading and the underwriting of risk refer to "the transfer of risk *characteristic of insurance*." *Pireno*, 458 U.S. at 130 (emphasis added). They contend that "risk characteristic of insurance" is "risk of loss resulting from the happening of a contingent event, such as the loss of a house by fire . . . or of a breadwinner by death." [Pl. Br. 24]. The Retirement CD, they argue, does not spread this type of risk, but spreads only an "investment risk," which they define as "the hazard of having insufficient investment acumen to outlive an asset." *Id.*

We are unpersuaded by plaintiffs' argument. First, describing the purchase of the Retirement CD as "hedging against faulty investment acumen," [Pl. Br. 18], does little to distinguish it from typical insurance; purchasing fire insurance can just as easily be described as "hedging against faulty fire prevention acumen." [Brief of Amicus Curiae American Council of Life Insurance p.6]. Second, the purpose of purchasing a life insurance policy on a family's breadwinner and of purchasing a lifetime annuity is essentially the same. The individual who purchases the life insurance policy insures against no longer having the money produced by the breadwinner, and the person who purchases a lifetime annuity insures against no longer having sufficient money produced by his assets. Finally, plaintiffs' attempt to distinguish insurance by claiming that it involves a loss caused by a single, contingent event overlooks an important aspect of the Retirement CD: By providing a guaranteed minimum return on investment, the Retirement CD insures the purchaser against a decline in the market—a single, contingent event. The purchaser is given the comfort that should a depression occur in the market, causing rates of interest to fall significantly, he will not suffer a "loss" of future income, but will continue to receive the rate of interest guaranteed in his Retirement CD contract. Furthermore, insurance policies do not always insure against circumstances that occur as a sudden event. For example, one is currently able to purchase an insurance policy that will provide nursing home

care to an individual when he finally reaches an age where he is no longer able to care for himself. In short, we conclude that the Retirement CD spreads policyholder risk in a manner similar to typical insurance and thus satisfies the first criterion of the *Pireno* test.

The Retirement CD satisfies the second and third *Pireno* factors as well. It is not only an "integral part" of the policy relationship between the insurer and the insured, it is the very document that evidences that relationship. It dictates the rights and obligations of both parties and sets forth the amount of deposit, date of first withdrawal, rate of interest, and the guaranteed amount of monthly payments. The third factor is met because the Retirement CD is an annuity, virtually all of which are issued by insurance companies. See *Barron's*, Oct. 3, 1994, at 23 (noting that nearly all of the $1 trillion worth of annuities currently in effect in the United States are issued by regulated insurance companies). Furthermore, forty-two state legislatures currently consider annuities to be an insurance industry activity and regulate them as such. [Brief of Amicus Curiae Council of Life Insurance, Ex. D (listing statutes)]; see also *SEC v. Variable Annuity Co.*, 359 U.S. at 69 ("All states regulate 'annuities' under 'insurance' laws."). They do so because a state's interests in regulating the sale of annuities are virtually identical to its interests in regulating the sale of typical insurance. States attempt to ensure that companies remain sufficiently solvent to meet their obligations to customers, which often do not arise until years after the customer purchases his policy. To do this, they require those companies frequently to submit financial statements and actuarial opinions to insurance regulators and to maintain minimal capital reserves.[5] Consumer protection concerns motivated states to enact insurance regulations in the first place, and are the reason they include annuities within those regulations.

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[5] See, *e.g.*, 215 ILCS 5/124-5/125.24a (regulation of company's investment); 215 ILCS 5/244 (limitations on company's expenses); 215 ILCS 5/244.1 (Commissioner action for financial conditions hazardous to policyholders).

Our determination that the Retirement CD is the "business of insurance" is further supported by the legislative history of the McCarran-Ferguson Act. While the legislative history contains no explicit debate on whether annuities were intended to be either included or excluded, both the House and Senate incorporated in their deliberations on the Act an August 29, 1944 report by the National Association of Insurance Commissioners ("NAIC"), the voice of state insurance regulators. The NAIC's opinion was important to the debate of the Act, as evidenced by the fact that the statute was a "modification of a measure which was originally drafted by the legislative committee of the [NAIC]." 91 Cong. Rec. 483 (Jan. 25, 1945) (Sen. O'Mahoney). As printed in the Congressional Record, that report seems to suggest that annuities were considered to be part of the "business of insurance":

> The insurance business has been alert to keep abreast with the ever-changing and expanding developments of American social and economic life. . . . Some idea of the complexity of the business may be gleaned from the fact that the insurance law of New York makes provision for *22 major kinds of insurance*; namely, life, *annuity*, accident and health, fire, miscellaneous property, water damage, burglary and theft . . . . 90 Cong. Rec. A3975-77 (NAIC report introduced by Rep. Anderson) (emphasis added) (Aug. 29, 1944).[6]

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[6] Plaintiffs contend that this reference is to "annuity insurance," which they claim is different from a typical annuity. In support of their claim they note that "annuity insurance" is defined in *Black's Law Dictionary* (6th ed. 1990) under "insurance" as "[a]n insurance contract calling for periodic payments to the insured or annuitant for a stated period or for life." Plaintiffs interpret this definition to include only situations where the beneficiary of a life insurance policy chooses to accept the proceeds of the policy in periodic payments as opposed to a lump sum. We do not believe the definition is as limited as plaintiffs suggest, especially given that an identical definition is provided for "annuity policy," which

(Footnote continued on following page)

Because the sale of the Retirement CD satisfies each of the Supreme Court's *Pireno* criteria, we conclude that the Retirement CD is properly considered the "business of insurance" for purposes of the McCarran-Ferguson Act.

C.

The final question is whether the Bank Act is an act that "specifically relates to the business of insurance" within the meaning of the final clause in Section 1012(b) of the McCarran-Ferguson Act. Given the Supreme Court's recent decision in *Barnett Bank*, *supra*, we must conclude that the provisions of the Bank Act before us do not "specifically relate to the business of insurance."

In *Barnett Bank*, a Florida statute prohibited banks from selling most types of insurance. The statute was in direct conflict with Section 92 of the Bank Act, which expressly permits national banks to act as insurance agents in towns with populations of 5000 people or less. Thus the question was whether the McCarran-Ferguson Act allowed the state statute to stand in face of the National Bank Act. The Supreme Court concluded that the McCarran-Ferguson Act did not apply because Section 92 of the Bank Act "specifically relates to the business of insurance." In reaching that conclusion, the Court focused on the fact that Section 92 "explicitly" grants national banks permission to sell insurance, and contains "specific" rules prohibiting banks from guaranteeing premium payments or the truth of statements made by an assured. *Barnett Bank*, 116 S. Ct. at 1111-1112. Thus Section 92 "not only focuses directly upon industry-specific selling practices, but also affects the relation of the insured to insurer and the spreading of risk." *Id.*

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[6] *continued*

is defined under "annuity." *Black's Law Dictionary* (6th ed. 1990) ("an insurance policy providing for monthly or periodic payments *to insured* to begin at a fixed date and continue through *insured's* life.") (emphasis added). If anything, these definitional references run counter to plaintiffs' position by demonstrating that annuities and insurance are frequently viewed as the same product.

The provisions of the Bank Act before us—the power "to accept deposits" and "to enter into contracts"—contain language quite different from that in Section 92. Neither provision "explicitly grants banks permission to conduct insurance-related activity;" neither focuses "directly on specific [insurance] selling practices;" and neither "affects the relation of the insured to insurer and the spreading of risk." *Id.* Thus neither "specifically relates to the business of insurance."

This conclusion is supported by the Court's statements regarding the basic purpose of the McCarran-Ferguson Act. The Court concluded that the purpose of the Act was not to insulate state insurance regulation from the reach of all federal law, but "to protect state regulation primarily against inadvertent federal intrusion—say, through enactment of a federal statute that describes an affected activity in broad, general terms, of which the insurance business happens to comprise one part." *Id.* at 1112. As applied to the Retirement CD, the provisions of the Bank Act at issue are exactly the intrusion the Court warned against: they describe an affected activity (banking) in broad terms, of which the insurance business (the Retirement CD) is only a part.

III.

The dissent expresses concern that even if we conclude that the McCarran-Ferguson Act allows Illinois to regulate the sale of the Retirement CD, we must then reach the "vexing" constitutional question of whether the banking activities of national banks are *ever* subject to state regulation. However, *Barnett Bank* demonstrates that the Bank Act possesses no unique immunity from the McCarran-Ferguson Act.

As stated above, the question in *Barnett* was whether a state statute could stand in the face of the Bank Act. The Court could have adopted the dissent's approach by concluding that the activities of national banks are simply not subject to state interference, regardless of the McCarran-Ferguson Act. However, that was not the approach taken by the Court. The Court undertook a de-

tailed analysis of Section 92 and concluded that the anti-preemption rule did not apply because Section 92 "specifically related to the business of insurance." *Id.* at 1113. Thus if the Court had concluded that Section 92 did not "specifically relate to the business of insurance," it would have applied the anti-preemption rule of the McCarran-Ferguson Act and allowed the Florida statute to stand in the face of the Bank Act. The Court left no doubt about this, as revealed in the following language:

> An amicus argues that our interpretation would give the [McCarran-Ferguson] Act "little meaning," because "whenever a state statute 'regulates' the business of insurance, any conflicting federal statute necessarily will 'specifically relate' to the insurance business." Brief for American Council of Life Insurance as Amicus Curiae 4. We disagree. Many federal statutes with potentially pre-emptive effect . . . use general language that does not appear to "specifically relate" to insurance; and where those statutes conflict with state law that was enacted "for the purpose of regulating the business of insurance," the McCarran-Ferguson Act's anti-pre-emption rule *will* apply. *Id.* (emphasis added).

Given *Barnett Bank*, we believe that the Bank Act, just like any other federal law, is within the reach of the McCarran-Ferguson Act.

IV.

Because the relevant sections of the Illinois Insurance Code were "enacted for the purposes of regulating the business of insurance," and because the Retirement CD is a fixed annuity and properly considered the "business of insurance," the McCarran-Ferguson Act requires that the Bank Act not be interpreted to impair or supersede those sections. Thus we affirm the decision of the district court that Illinois may regulate the sale of the Retirement CD, despite the fact that selling the Retirement CD may be a practice that the National Banking Act expressly authorizes.

DIANE P. WOOD, *Circuit Judge*, concurring. The Retirement CD that Blackfeet National Bank wants to offer in Illinois is, as the majority opinion notes, an innovative product. Therein lies the core difficulty for this case. In the face of the creativity and innovation that is taking place in financial markets, we are obliged to decide whether the act of offering this particular Retirement CD amounts to engaging in the "business of insurance," within the meaning of the 1945 statute commonly known as the McCarran-Ferguson Act, 15 U.S.C. § 1012. The dissent makes a number of compelling policy arguments, and I have little doubt that permitting national banks to issue innovative, hybrid instruments such as the Retirement CD would be beneficial to competition as a whole. Nevertheless, our job is not to question the wisdom of the statutes Congress has passed or the rules Congress has given us for determining how those statutes relate to one another. From that perspective, it seems clear to me that the principal opinion has come to the only conclusion that is consistent with the language of the relevant statutes, governing Supreme Court precedent and the economic function of the Retirement CD.

The dissent argues extensively that annuities should not be considered insurance products, noting a number of differences between the two products like the types of risks covered, the methods of payment, and the purposes for which they are designed. It notes, correctly, that many investment vehicles and contracts that address mortality risk are plainly not part of the "business of insurance." Where the dissent is ultimately unconvincing is in its application of the test for determining what constitutes the "business of insurance" as a matter of federal law for purposes of § 1012.

On this point, I agree that the Supreme Court's decisions in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 127-129 (1982), and *Group Life & Health Ins. v. Royal Drug Co.*, 440 U.S. 205, 211-17 (1979), establish the governing criteria both for the second (antitrust) clause of § 1012 and for the first clause. Under the first criterion,

it is not enough to establish that the practice deals with a certain type of risk (here, mortality risk); we must go further and consider whether the practice has the effect of transferring or spreading that risk. To take one example from the dissent, a grantor assumes a mortality risk when she confers a life estate in land to another party, but there is no necessary transfer or spread of that risk to a larger population. The Retirement CD, in contrast, like all annuities, spreads mortality risk among all holders of the CD. If the issuer has good actuaries, it will earn money overall on its Retirement CDs, even if some individual customers live longer than their predicted life spans. Annuities are the same as life insurance policies in this respect: in each case, the accuracy of the issuer's predictions about the mortality of the customer population determines how profitable the issuer's business will be. For this purpose, it does not matter whether in one case the issuer is gambling that the customer will not die too soon, or in the other case it is gambling that the customer will not die too late. In both situations, there is an ascertainable risk that is spread or transferred. In addition, for the reasons the majority offers, the annuity aspect of the Retirement CD is an integral part of the contractual relationship between the issuer and the customer. Finally, even though other entities may issue annuities, dissent at 46 n. 22, the dissent offers no evidence to refute the statistics cited by *amicus* American Council of Life Insurance to the effect that the overwhelming majority of the $1 trillion of annuity contracts in the U.S. are issued by regulated insurance companies. Thus, the third factor of *Pireno/Royal Drug* is satisfied here as well.

The fact that Blackfeet is a national bank is important to the analysis only because it requires us to decide whether the "reverse preemption" provisions of the McCarran-Ferguson Act apply in these circumstances or not. The mere fact that national banks are permitted to sell the Retirement CD does not mean that contrary state regulation is supplanted. In *Barnett Bank of Marion County v. Nelson*, 116 S.Ct. 1103, 1108 (1996), the Supreme Court

noted that the purpose of the provision of the National Banking Act authorizing banks in towns with populations of less than 5,000 to sell insurance, 12 U.S.C. § 92, might have been to allow banks that power as long as states also gave their permission. The Court concluded that the unqualified language of the statute made that interpretation untenable. In this case, however, the Office of the Comptroller of the Currency (OCC) noted twice that state insurance laws might apply to the Retirement CD. *Ante*, at 4 n. 2. The OCC would certainly have taken a different tack if it believed that state laws necessarily had to yield to the powers of national banks to engage in this kind of business. I am therefore satisfied that our decision does not raise concerns under either the Supremacy Clause or the National Banking Act. The majority has simply reconciled two bodies of federal law in a manner that respects the Congressional limitations on each.

For these reasons, as well as for the reason set forth in the principal opinion, I agree that the judgment below must be affirmed.

FLAUM, *Circuit Judge*, dissenting. This case boils down to one fundamental question: is the selling of the Retirement CD by national banks like Blackfeet appropriately characterized as "the business of insurance" under McCarran-Ferguson.[1] If the selling of this product by national banks

[1] I fully agree with the majority's conclusion that the provisions of the National Bank Act relevant to this case do not "specifically relate[ ] to the business of insurance" under section 1012(b) of McCarran-Ferguson. In other words, this case is unlike *Barnett Bank of Marion County, N.A. v. Nelson*, 116 S. Ct. 1103 (1996), where the Supreme Court addressed a section of the National Bank Act, 12 U.S.C. § 92, which specifically authorizes national banks to sell insurance in towns with populations no greater than 5000 people. Not surprisingly, the Court held that this portion of

(Footnote continued on following page)

is appropriately characterized as "the business of insurance," Illinois can choose to regulate the activity under its insurance code, and there is no federal preemption issue because McCarran-Ferguson directs that the "business of insurance" is presumed to be the province of the states.[2] 15 U.S.C. § 1012. But if the selling of this annuity product by a national bank is *not* "the business of insurance," McCarran-Ferguson does not protect Illinois' attempt to regulate this national bank practice.

As the majority properly recognizes, *see supra* p. 7, the meaning of "insurance" (or "the business of insurance") within a federal statute like McCarran-Ferguson is a federal question. See *Securities and Exchange Comm'n v. United Benefit Life Ins. Co.*, 387 U.S. 202, 210 (1967); *Securities and Exchange Comm'n v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959) (hereinafter *VALIC*). In *VALIC*, the Supreme Court noted that states disagree as to the nature of "insurance" and "annuity" contracts. The Court emphasized, however, that in the context of the federal Securities Act, "how the States may have ruled is not decisive. . . . [T]he meaning of 'insurance' or 'annuity' under . . . Federal Acts is a federal question." *Id.* Thus a conclusion by Illinois, or any other state, that a particular practice constitutes "the business of insurance" has no bearing on our inquiry whether that state regulation actually qualifies as protected state insur-

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[1] *continued*

the National Bank Act *did* "specifically relate[ ] to the business of insurance." *Id.* at 1106. Thus that section "falls within the scope of [ ] McCarran-Ferguson's 'specifically relates' *exception* to its anti-pre-emption rule." *Id.* at 1112-13 (emphasis added). Consequently, that federal insurance provision preempts state law to the contrary. *Id.* at 1111. Our case involves neither a federal insurance provision nor an exception to the general principles of McCarran-Ferguson; it involves defining what "the business of insurance" means and what activities it includes.

[2] There may still be, however, a *supremacy* issue. *See infra* section IV.

ance regulation under McCarran-Ferguson.[3] *See Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 230 n.38 (1979).

In my view, were it not for the Supreme Court's recent, unanimous decision in *NationsBank of North Carolina*,

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[3] It should be noted that if this state regulation is not legitimately classified as "insurance business" under 215 ILCS 5/121 (forbidding transaction of "insurance business" in Illinois by companies not possessing an Illinois certificate of authority), the Illinois Insurance Code does not apply anyway. Other states have held, in various contexts, that annuities are *not* insurance and should not be treated as such. *See, e.g., New York State Ass'n of Life Underwriters v. New York State Banking Dep't*, 632 N.E.2d 876, 881 (N.Y. 1994) (holding that state banks are authorized to sell annuities because "the great weight of authority supports the position that annuities are not insurance"); *Cruthers v. Neeld*, 103 A.2d 153 (N.J. 1954) (holding that refund annuity contracts are not life insurance policies for purposes of inheritance tax); *Corporation Comm'n v. Equitable Life Assurance Soc'y*, 239 P.2d 360, 362 (Ariz. 1951) (holding that proceeds from annuity sales not subject to state insurance premiums tax because "annuities are not indemnities for death but are investments for life"). The appellee has not provided specific authority (such as a holding by an Illinois court) for the claim that Illinois completely prohibits the selling of annuity products by entities other than insurance companies. Yet it is certainly possible that "insurance business" under the Illinois Insurance Code covers a broader range of activity than "the business of insurance" under the federal statute, section 1012 of McCarran-Ferguson, and includes all selling of annuities by state entities. Because I would conclude that Illinois cannot regulate the selling of the Retirement CD by national banks, however, I do not believe this case forces us to determine the scope of "insurance business" under Illinois law. Thus I would leave open the possibility that Illinois could forbid the selling of annuities by *state* banks, by defining this activity as "insurance business," though I maintain that it has no power to forbid their issuance by *national* banks, since the National Bank Act apparently allows the practice, *see infra* section IV, and it is not preempted by McCarran-Ferguson. *Cf. Barnett Bank*, 116 S. Ct. at 1111 (noting that 12 U.S.C. § 92 "grant[s] small town national banks authority to sell insurance, whether or not a State grants its own state banks . . . similar approval").

N.A. v. Variable Annuity Life Ins. Co., 115 S. Ct. 810 (1995), the majority's resolution of the difficult question at hand would be quite plausible and arguably correct. Upon careful consideration of the Court's approach in *NationsBank*, however, I do not believe we can confidently reach the conclusion reached by the majority. And when the *NationsBank* analysis is added to the substantial insurance literature and dictionary evidence specifically rejecting the claim that annuities are a type of "insurance," I must conclude that the selling of annuity-type instruments by national banks cannot reasonably be characterized as "the business of insurance" under McCarran-Ferguson, and thus subject to the Illinois Insurance Code.[4] Prior decisions from the Supreme Court and this circuit only strengthen this conclusion. In addition, the result reached by the majority raises the vexing constitutional question of whether a state can forbid activity by a national bank that is authorized under federal law.[5]

I. The *NationsBank* Decision

The majority quite correctly notes that the *NationsBank* Court did not address the precise issue before us, since

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[4] Exception must be taken to the suggestion in Judge Wood's concurring opinion that this dissent "makes a number of compelling policy arguments," *supra* at 19, since the opinion advances no policy arguments. The conclusion of this dissent, that Illinois cannot regulate a national bank's selling of the Retirement CD, is based upon Supreme Court precedent in the insurance realm, general insurance treatises, and dictionary evidence—all in an attempt to clarify the meaning of the terms "insurance" and "the business of insurance." While it may well be true that certain policy arguments support my position and that the proposed result "would be beneficial to competition as a whole," *id.*, the opinion does not invoke such arguments.

[5] Although the majority does not actually address this issue, I believe that we must consider the supremacy implications of allowing a state agency to regulate a national bank if we are going to resolve this case as the majority does. *See infra* section IV.

that decision involved the power of a national bank to act as a *broker* in the sale of annuities, not whether such a bank could directly *issue* annuities. In addition, that case did not involve any attempt by a state to regulate the activities of a national bank under its own insurance code. The Supreme Court appropriately limited its holding to the actual case before it, but that does not suggest that we should ignore the approach taken by the Court and the reasoning and authorities upon which it relied. Ultimately, in my judgment, the Court's analysis in *NationsBank* strongly points to the determination that the selling of annuities by national banks is not reasonably regarded as the business of insurance.

The *NationsBank* Court accepted the conclusion of the Comptroller of the Currency that annuities are widely recognized as "investment products."[6] *Id.* at 814. Justice Ginsburg, writing for the entire Court, described annuities as follows:

> By making an initial payment in exchange for a future income stream, the customer is deferring consumption, setting aside money for retirement, future expenses, or a rainy day. For her, an annuity is *like putting money in a bank account*, a debt instrument, or a mutual fund. Offering bank accounts and acting as agent in the sale of debt instruments and mutual funds are familiar parts of the business of banking . . . . In sum, modern annuities, though more sophisticated than the standard savings bank deposits of old, answer essentially the same need. By providing customers with the opportunity to invest in one or more annuity options, banks are *essentially offering financial investment instruments* of the kind congressional authorization permits them to broker.

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[6] The Court defined "annuities" as follows: "Annuities are contracts under which the purchaser makes one or more premium payments to the issuer in exchange for a series of payments, which continue either for a fixed period or for the life of the purchaser or a designated beneficiary." *NationsBank*, 115 S. Ct. at 812.

Id. (emphasis added) (citations omitted). Hence the Court accepted the view that annuities are properly described as "investment instruments" and are analogous to bank accounts.

The *NationsBank* Court also addressed the argument, asserted by the respondents in that case and relied upon by the majority in this case, that annuities should be considered "insurance" because they traditionally have been sold by insurance companies. The Court stated: "[T]he sale of a product by an insurance company does not inevitably render the product insurance. For example, insurance companies have long offered loans on the security of life insurance, . . . but a loan does not thereby become insurance." *Id.* The Court considered and rejected the proposition that a historical association of insurance companies with a particular product mandated the conclusion that the product is "insurance." The *NationsBank* Court also recognized that most states have regulated annuities as insurance, but noted that this regulation had more to do with the fact that insurance companies are likely to *sell* annuities than with a conclusion that annuities *are* insurance: "Treatment of annuities under state law . . . is contextual. States generally classify annuities as insurance *when defining the powers of insurance companies and state insurance regulators*. . . . But in diverse settings, States have resisted lump classification of annuities as insurance." *Id.* (emphasis added) (citations omitted).[7]

The Court emphasized that a classification—such as the treatment of annuities as insurance within the confines of insurance law—that makes sense in one setting may not work in another: "As our decisions underscore, a characterization fitting in certain contexts may be unsuitable in others." *Id.* at 816. Thus the *NationsBank* Court approved the Comptroller's "functional" approach to classifying annuities as "not 'insurance' " under the Na-

[7] *See supra* note 3 (noting some of the state cases concluding that annuities are not "insurance").

tional Bank Act: "The Comptroller's classification of annuities, based on the tax deferral and investment features that distinguish them from insurance, in short, is at least reasonable." *Id.* at 817. The Court recognized that the "key feature of insurance is that it *indemnifies loss*," *id.* (emphasis added), while annuities "serve an important *investment purpose* and are functionally similar to other investments that banks typically sell." *Id.* (emphasis added).

One other aspect of the *NationsBank* decision is important to note, particularly because the issue plays a prominent role in the majority's analysis: the concept of "mortality risk." The respondents in *NationsBank* argued, as the Illinois Director of Insurance does here, that annuities resemble insurance because some annuities contain a mortality risk element. The majority accepts this argument, but there are at least two significant reasons why this approach does not hold up. The first reason comes directly from *NationsBank*, while the second is more general and is addressed in section III below. Regarding *NationsBank*, the Supreme Court specifically rejected "mortality risk" as the hallmark of whether a product is "insurance" or not. The *NationsBank* Court noted that a life interest in real property imposes a "mortality risk" on the purchaser. *Id.* at 816. The price of such an interest is presumably calculated according to the expected life of the purchaser (or whoever is to be used as the "measuring life"). If the purchaser lives longer than expected, say to the ripe old age of 110, the seller will be the loser—having sold the interest for less than it turned out to be worth. If the purchaser (or the person who is the measuring life) dies young, the purchaser will be the economic loser, since he or she will not have gotten the expected economic benefit out of the life interest. The "mortality risk" for the purchaser in such a life estate is the risk of dying before you have gotten the full value out of your purchased interest, while the risk for the seller is that the purchaser lives longer than expected. The *NationsBank* Court made clear, however, that "a life interest in real property is not insurance, although it imposes some

mortality risk on the purchaser." *Id.* The Court further noted that some conventional debt instruments impose a similar mortality risk without thereby becoming "insurance." *Id.*

II. The Literature

The opinion in *NationsBank* and other recent Supreme Court opinions considering the scope of "the business of insurance" are instructive not only for what they say, but for the sources they look to for authoritative support. The modern Court has shown a readiness to look to "the literature" on insurance, including insurance treatises, legal dictionaries, and general dictionaries, for guidance in determining the meaning of "insurance" and the appropriate scope of McCarran-Ferguson's "business of insurance" language. After reviewing this literature in regard to the question now before us, I find that it is nearly unanimous in directing us to the conclusion that the selling of a specialized annuity by a national bank is not "the business of insurance."

The *NationsBank* Court twice relied on Appleman & Appleman's insurance treatise as authoritative on the proper understanding of annuities and insurance—once for the proposition that annuities are primarily investment products, 115 S. Ct. at 815, and once for the proposition that the sale of a product by an insurance company does not inevitably render the product insurance. *Id.* Appleman & Appleman recognize a clear distinction between "annuities" and "insurance." They note that annuities are often used as tax-saving devices and may be established by charitable gifts and gifts within a family, as well as being sold by institutions like insurance companies. 1 JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 81 (1981). In a section entitled "Annuities Issued by Life Insurance Companies," Appleman & Appleman specifically consider the question whether annuities are "insurance" and decisively find that they are not. *Id.* at § 84. They begin as follows: "Ordinarily, it is recognized, even by laymen, that contracts of life insurance and

of annuity are distinctly different."[8] *Id.* They note that life insurance generally involves the insured making set payments, called "premiums," over a period of years that entitle a designated person other than the insured to payment of a fixed amount in the event of the insured's death. They point out that "[a]n annuity contract is almost diametrically opposed to this," since it traditionally involves the designated recipient *paying* for the product, while the *issuer* takes on the obligation of making periodic (usually yearly) payments in a fixed amount. *Id.* Rather than "creating an immediate estate for the benefit of others," as the purchaser of insurance does, the purchaser of an annuity "has reduced his immediate estate in favor of future contingent income." *Id.* Appleman & Appleman conclude: "Annuity contracts must, therefore, be recognized as *investments rather than as insurance.*" *Id.* (emphasis added) (quoted in *NationsBank*, 115 S. Ct. at 815).

The Supreme Court has also relied upon Couch's Cyclopedia of Insurance Law when addressing questions about the nature of insurance, particularly the risk-spreading aspect of insurance. *See, e.g., Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 127 n.7, 130 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 (1979). Couch entitles one of his sections "Annuity as Distinguished from Insurance." 19 GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 81:2 (2d ed. 1983). In this section Couch considers various state, federal, and Supreme Court decisions, as well as legal and insurance commentary, all of which point to the conclusion that annuities are generally *not* "insurance." Couch concludes,

> An annuity contract differs materially from an ordinary life insurance contract in that it is payable during the life of the annuitant rather than upon a

[8] The Supreme Court has recently reminded us of the importance of looking to "ordinary English" when interpreting terms within the McCarran-Ferguson Act. *Barnett Bank*, 116 S. Ct. at 1111 (referring three times to "ordinary English").

> future contingency, and in many instances it is paid for in a single payment which is not generally regarded as a premium. Consequently, a company engaged in selling annuities is not subject to a statute applicable to "insurers" unless the statute expressly so declares.

Id. at § 81.2, pp. 638-89. Under the Couch analysis, the selling of annuities should not be considered "the business of insurance" under the McCarran-Ferguson Act, since the Act does not *expressly* define the issuing of annuities as part of "the business of insurance."[9]

The two dominant legal encyclopedias, American Jurisprudence ("Am. Jur.") and Corpus Juris Secundum ("C.J.S."), likewise strongly direct the conclusion that annuities are not "insurance" and that the selling of annuities is not "the business of insurance." C.J.S., in particular, does an excellent job of illuminating the distinction between annuities and true insurance products. C.J.S. notes that the term "annuity," as it is currently used, "designates a fixed sum, granted or bequeathed, payable periodically, at aliquot parts of a year, at stated intervals, and not necessarily annually." 3A C.J.S. *Annuities* § 2 (1973). C.J.S. also recognizes annuities as being a form of investment, rather than a brand of life insurance: "An annuity is not an indemnity against loss of death, but is essentially a form of investment, notwithstanding the fact that in its usual form payments are dependent upon the continuity of the grantee's life." *Id.* The basis for this conclusion is explained in a later section that specifically addresses the difference between annuities and insurance.

> An annuity contract differs from an insurance contract, and it comprehends few of the elements of an

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[9] The Couch analysis would leave open the possibility, also noted *supra* at note 3, that a state could define annuities as "insurance" under its own insurance code and thus proscribe their sale by non-insurance company state entities (like state banks).

> insurance contract. An annuity contract is distinguished from an insurance contract in that insurance, as generally understood, is an agreement to indemnify against loss in case of property damaged or destroyed or to pay a specified sum on the death of insured or on his reaching a certain age, while an annuity is generally understood as an agreement to pay a specified sum to the annuitant annually during life.
>
> *From an insurer's viewpoint insurance looks to longevity, while annuity looks to transiency.* An annuity is a provision for life with *no indemnity feature*; the risk assumed is to pay as long as the insured may live, and it is *not based on contingency of loss.*
>
> The existence of the contingency that payments are dependent upon the continuity of the annuitant's life does not bring an annuity within the classification of insurance. An annuity is not an insurance contract [even if] it provides for death benefits, refund annuities, or continuation of payments to a designated person after the primary beneficiary's death.

Id. at *Annuities* § 3(c) (emphasis added).

The C.J.S. chapter on "insurance," which has been updated recently, reaffirms the distinction between annuities and insurance. C.J.S. recognizes that "the underwriting of risk" has been commonly conceived by the courts and in popular understanding as the "earmark of insurance." 44 C.J.S. *Insurance* § 2(a) (1993); *see, e.g., VALIC*, 359 U.S. 65, 73 (1959); *see also infra* section III. This underwriting of risk involves two basic elements: the shifting of loss from the insured to the insurer (commonly called "risk transfer") and a distribution of risk among similarly situated persons (often called "risk spreading"). 44 C.J.S. *Insurance* § 2(a). But the term "risk" in the insurance context is used in a narrow, specific sense that accords with the traditional definition of "insurance." C.J.S. notes that "risk" in the insurance sense deals with loss or injuries that occur due to a "particular peril" that is insured against (such as death, fire, accident, or property

damage), which results from the occurrence of a specific "casualty" or "fortuitous event"—an event which, so far as the parties to the contract are concerned, is dependent on chance. *Id.* at *Insurance* § 860. Accordingly, "Insurance has been said to be best defined as a contract whereby one undertakes to *indemnify* another against *loss, damage, or liability* arising from an *unknown or contingent event.*" *Id.* at § 2(a) (all emphasis added).

Annuities, however, do not involve indemnification, loss/damage/liability, or contingent events. Annuities generally involve fixed payments determined by an agreed-upon investment feature (principal plus a guaranteed rate of interest),[10] rather than by the need to indemnify a particular economic loss. Annuity payments are given out according to a pre-set schedule, rather than when something "bad" happens. Thus there is no loss, damage, or liability component. Annuity payments do not *commence* with a contingent event, but rather begin on a contractually-established date and *continue* over a period of time—either to a pre-set ending point (such as a period of years) or *until* the occurrence of a contingent event (such as the death of the annuitant).[11] After considering the implications of the C.J.S. definition of "insurance," it is not sur-

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[10] Even variable annuities, under which the amount of payments can vary according to the investment success of the issuer, involve an agreed-upon formula for calculating the payments to be made. *VALIC*, 359 U.S. 65, 69-72 (1959).

[11] Even the broadest definition of "insurance" proposed by C.J.S. would not encompass annuities. According to this broader definition, insurance "denotes a contract by which one party, for a compensation called the 'premium,' assumes particular risks of the other party and promises to pay to him or his nominee a certain or ascertainable sum of money on a specified contingency." 44 C.J.S. *Insurance* § 2(a) (1993). Annuities, however, do not involve "premiums," nor do they involve a payment of money at the occurrence of a specified contingency. At best, annuities involve fixed payments *until* a specified contingency; but this does not fall within even the broad definition of "insurance."

prising that the C.J.S. treatment of annuity contracts in this chapter is short and conclusory: "Generally an annuity contract is not a contract of insurance." *Id.* at § 2(b).

Am. Jur. likewise defines "insurance" in a way that seems to preclude a finding that an annuity could qualify as insurance. Am. Jur. recognizes that "insurance," even broadly defined, provides for the payment of "a certain or ascertainable sum of money on a specified contingency." 43 AM. JUR. 2D *Insurance* § 1. Am. Jur. also notes that the authorities substantially agree that insurance involves a payment "on the destruction, death, loss, or injury of someone or something by specified perils." *Id.* Am. Jur. thus recognizes that an insurance contract traditionally comes to fruition with the occurrence of "an unknown or contingent event" or a "specified peril." *Id.* Hence its conclusion regarding annuities, by now familiar, is not surprising: "Contracts for annuities differ materially from ordinary life insurance policies, and are not generally regarded as such. Consequently, a company engaged merely in selling annuities *does not conduct an insurance business*, and is not an insurance company unless made so by a broad statutory definition of insurance companies." *Id.* at *Insurance* § 5 (emphasis added). Once again, McCarran-Ferguson does not define "insurance" to include annuities, nor does it define "insurance company" so as to include an entity that merely sells annuities.

This literature section would not be complete without also addressing the dictionary evidence on the meaning of "insurance." The Supreme Court has looked to Black's Law Dictionary and Webster's New International Dictionary in this regard. *See, e.g.*, *NationsBank*, 115 S. Ct. 810, 817 (1995) (quoting the Black's Law Dictionary definition of "insurance"); *Royal Drug*, 440 U.S. 205, 211 n.7 (1979) (quoting Webster's New International Dictionary definition of "insurance"). I do the same. Black's defines "insurance" as follows:

> A contract whereby, for a stipulated consideration, one party undertakes to compensate the other for

> loss on a specified subject by specified perils. . . . A contract whereby one undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event and is applicable only to some contingency or act to occur in the future.

BLACK'S LAW DICTIONARY 802 (6th ed. 1990). Once again, the emphasis on *loss* that occurs due to some specific peril or contingent *event*, at which time (and not before), the protected party will be *indemnified* simply does not allow for the conclusion that an annuity can qualify as "insurance." Not only is the language of insurance ("underwrite," "policy," "premium," etc.) totally different from that of annuities, the substance and effect of an insurance agreement is totally different from that of an annuity agreement.[12]

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[12] The Black's Law Dictionary definitions of "annuity insurance" and "annuity policy," noted by the majority *supra* at p. 15, n.6, might initially seem to undermine the conclusion that an annuity is not properly characterized as "insurance." For while the general definitions of "annuity" and "insurance" in Black's would make these terms mutually exclusive, the reference to the term "annuity insurance" under the main definition of "insurance" and the separate definition of "annuity policy" do seem to contemplate an overlap between insurance and annuities. The definition given by Black's for "annuity policy" is as follows: "An insurance policy providing for monthly or periodic payments to insured to begin at fixed date and continue through insured's life. *Hamilton v. Penn Mut. Life Ins. Co.*, 196 Miss. 345, 354, 17 So.2d 278, 280 (1944)." BLACK'S LAW DICTIONARY 90 (6th ed. 1990). (Actually, the holding in *Hamilton* was that annuities are most certainly *not* life insurance; the court simply found that because insurance companies are authorized to *issue* the policies, they were subject to state insurance laws regulating the business of life insurance. 17 So.2d at 279-80.) And the Black's definition provided for "annuity insurance," which appears in a list of nearly 100 types of insurance located within the main definition of "insurance," is nearly equivalent: "An insurance contract calling for periodic payments to the insured or annuitant for a stated period or for life." BLACK'S LAW at 802. Based on Black's more general definitions of "annuity" and "insurance," however, it appears that the defin-

(Footnote continued on following page)

Webster's definition of "insurance" simply substantiates and echoes those provided above. It reads as follows:

> **1 a** : the action or process of insuring or the state of being insured usu. against loss or damage by a contingent event (as death, fire, accident, or sickness) **b** : means of insuring against loss or risks . . . **2 a** : the business of insuring persons or property; *specif.* : a device for the elimination or reduction of an economic risk common to all members of a large group and employing a system of equitable contributions out of which losses are paid **b** : coverage by contract whereby for a stipulated consideration one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril . . . .

WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1173 (1993) (emphasis in original). By now the refrain is more than familiar to the reader. The focus on indemnifying against economic loss/damage due to future, contingent events/perils simply belies any attempt to place annuities within the ambit of the term "insurance." Insurance companies may well be allowed to sell annuities, just as they

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[12] *continued*

ing of these terms simply results from the fact that insurance *companies* have long been associated with selling annuities, which they have sometimes termed "annuity insurance" or "annuity policies"—"policy" being a word specifically associated with the insurance industry and used to refer to the written insurance contract, as Black's notes in its main definition of "insurance." *Id.* Thus I interpret Black's recognition and definition of the terms "annuity insurance" and "annuity policy," which are basically oxymorons under my analysis, simply to reflect acknowledgement of the loose way in which these terms have sometimes been used (particularly within the insurance industry), rather than an indication that annuities can reasonably be classified as a type of insurance. Among the insurance treatises I reviewed, all of which contained long lists of the myriad different types of insurance available, I did not find one reference to "annuity insurance." In my view, the term is simply a misnomer for annuity products that are sold by insurance companies.

are sometimes allowed to make loans, but they are *not* engaging in the "business of insurance" when they do so.

Yet amidst the modern literature on the scope of "insurance," there is at least one respected treatise that does appear to place some annuities within the realm of "insurance." *See* ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 1.5(c) (1988) (stating that the class of insurance termed "life insurance" includes traditional life insurance, personal accident insurance, health insurance, and annuity contracts). And the Supreme Court has looked to Keeton's insurance law treatise for guidance in previous insurance cases—though never for the proposition that an annuity can be considered "insurance" and not in *NationsBank*—so it seems prudent to consider it here. *See, e.g.*, *Pireno*, 458 U.S. 119, 127 n.7, 131 (1982) (citing Keeton for recognition of risk transfer and distribution elements of insurance and for claim that insurance policy itself defines scope of risk transferred); *Royal Drug*, 440 U.S. 205, 211 (1979) (citing Keeton's description of insurance as "arrangement for transferring and distributing risk"). Although Keeton emphasizes the significance of the risk transfer and distribution elements of "insurance," he recognizes that these components alone do not make something "insurance." "Insurance is generally understood to be an arrangement for transferring and distributing risks. Unfortunately, this characterization is neither very precise nor universally applicable as a definition of insurance because it describes many other arrangements and relationships which almost uniformly are not regarded or treated as insurance transactions." *Id.* § 1.1(b). Specifically, Keeton notes that a warranty that guarantees the quality of merchandise, an agreement to maintain a vehicle in good repair, and even an attorney's agreement to take a case for a fixed fee all involve risk transfer and risk distribution; yet such contractual arrangements "almost uniformly are not treated as insurance transactions" and are not subject to state insurance codes. *Id.* at § 1.2.

Thus Keeton recognizes the difficulty of formulating an appropriate, generalizable definition of "insurance," and

he emphasizes that a definition suitable in one context may be lacking in another: "There is no single conception of insurance that is universally applicable for use in disputes involving questions of law." *Id.* § 1.1(b). Nonetheless, Keeton does offer a basic definition of "insurance," which accords with the definitions considered above. He writes, "An insurance contract generally involves an agreement by which one party (usually identified as an insurer) is committed to do something which is of value for another party (usually identified as an insured or a beneficiary) *upon the occurrence of* some specified contingency." *Id.* (emphasis added). Yet this definition, even acknowledging Keeton's caveat about not demanding perfect, overarching definitions, raises substantial questions about Keeton's willingness to treat some annuities as "insurance."

Keeton describes annuities as follows:

> An annuity contract ordinarily provides for the payment of a fixed-dollar annual benefit commencing at a specified date and continuing *as long as* the annuitant lives. The traditional annuity contract is in essence and in principal purpose a risk transferring and a risk distributing contract, and this type of contract is *frequently treated* as a form of insurance. The uncertainty in this context is the risk of long life, in which case the annuity contract will pay the annuitant substantially more than the company received (as a result of both premium payments and investment earnings) on behalf of that annuitant to create the annuity benefit.

Id. at § 1.5(c)(4) (emphasis added). What Keeton does not explain (and what the other commentators appear to find decisive) is why a product that provides for payment "upon the occurrence of" some specified event (i.e., beginning with that event), as insurance does, should be treated as equivalent to a product that provides for payment "as long as" or until some specified event occurs (i.e., ending with that event), as an annuity does. The majority notes this feature by calling annuities the "mirror image" of insurance. *See supra* p. 11. But to my mind, the mirror

image of something is the reverse of that thing, which in this case amounts to annuities being the *opposite* of insurance.

Keeton does note that "refund annuities" are more like investments, and less like insurance, than traditional annuities.[13] KEETON at § 1.5(c)(4). The Retirement CD is a refund annuity. The purchaser of the Retirement CD is guaranteed a return of at least the accrued value (principal plus interest) of the CD up until the maturity date. If the purchaser dies before the maturity date, the value of the CD at the time of death (all contributions made plus accrued interest) will be disbursed to the annuitant's estate or designated beneficiary. Likewise, if the annuitant dies after the maturity date but before the annuity payments received total the value of the CD as of the maturity date, the annuitant's estate or designated beneficiary will be given the difference between the value of the CD as of the maturity date and the total of the payments already received. Thus it is even more inappropriate to call the Retirement CD "insurance" than it is to call traditional annuities "insurance." Perhaps Keeton himself would not do so.

III. Caselaw

The parties have not presented, and I am not aware of, any Supreme Court or federal circuit court case that addresses the issue before us: the power of a state to regulate as "insurance" the selling of an annuity product by a national bank. The recent *NationsBank* case, discussed in section I above, is the most relevant authority

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[13] A "refund annuity" is one in which the "[a]nnuitant is assured a specified annual sum during his life, with the further assurance that in the event of his premature death there will be paid to his estate an additional amount which represents the difference between the purchase price and the amount paid out during annuitant's life." BLACK'S LAW DICTIONARY 90 (6th ed. 1990); *see also* 3A C.J.S. *Annuities* § 2 (1973).

on the issue, but some of the other cases relied upon by the majority are worth taking up, both for the aid they can provide in addressing the issue before us and to recognize their limitations.

The concept of "mortality risk" and the distinction between "insurance risk" and other types of risk have been addressed by the Supreme Court as early as the 1940's and 50's. In *Helvering v. Le Gierse*, 312 U.S. 531, 539 (1941), the Court emphasized that for a contract to qualify as "insurance" under a federal statute, it must contain "an actual 'insurance risk.' "[14] The *Le Gierse* Court explained that implicit in "the word 'insurance' in its commonly accepted sense. . . . is acknowledgement of that fact that usually insurance payable to specific beneficiaries is designed to shift to a group of individuals the risk of premature death of the one upon whom the beneficiaries

[14] In *Le Gierse*, 312 U.S. 531, the Court was considering whether the proceeds of a particular insurance policy, issued jointly with an annuity contract, were includable within the decedent's gross estate for federal estate tax purposes. Under the Revenue Act, money "receivable as insurance" by beneficiaries of the deceased, up to $40,000, could be excluded from the decedent's gross estate. The *Le Gierse* Court found that the annuity contract and the life insurance policy had to be considered together and that they "counteracted each other." *Id.* at 540-41. The Court emphasized that the cumulative effect of the annuity contract and the insurance contract, which were issued by the same insurance company and would not have been issued separately, nullified the "insurance risk" that otherwise would have been part of the life insurance contract. *Id.* at 541 ("[I]n this combination the one neutralizes the risk customarily inherent in the other."). The Court held that because the "insurance risk" of the life insurance policy was counteracted by the "investment risk" of the annuity policy, the proceeds from the insurance policy did not qualify for the estate tax "insurance" exemption. *Id.* at 542 ("Any risk that the [annuity] prepayment would earn less than the amount paid to respondent as an annuity was an investment risk similar to the risk assumed by a bank; it was not an insurance risk . . . ."). The Court viewed annuities and insurance as opposites: "From the company's viewpoint, insurance looks to longevity, annuity to transiency." *Id.* at 541.

are dependent for support." *Id.* at 540. In other words, the "insurance risk" shifted through life insurance is the *economic* risk of losing a breadwinner. The *Le Gierse* Court also contrasted the "insurance risk" of true insurance with the "investment risk" of annuities and stated that "annuities and insurance are opposites." *Id.* at 542, 541.

Similarly, in *Securities and Exchange Comm'n v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (*VALIC*) (cited by the majority *supra* p. 12), the Court considered whether the variable annuities at stake were "insurance" for purposes of the Securities Act of 1933, McCarran-Ferguson, and the Investment Company Act.[15] After noting that the question at stake was one of federal law, *id.* at 69, the Court considered the respondents argument that the variable annuities contained "mortality risk," which made them "insurance."[16] The Court found that

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[15] The case involved an attempt by the Securities and Exchange Commission to require that variable annuities be registered as securities under the Securities Act of 1933. The respondent insurance companies maintained that McCarran-Ferguson applied, since several states and the District of Columbia regulated the annuities under their insurance codes. They also claimed that the annuities were exempt under the Securities Act itself, which exempts *both* annuities and insurance, *see infra* note 18, as well as the Investment Company Act. The Court simplified the question at issue to the element shared by all three statutes: "The question common to the exemption provisions of the Securities Act and the Investment Company Act and to § 2(b) of the McCarran-Ferguson Act is *whether respondents are issuing contracts of insurance*." *VALIC*, 359 U.S. at 68 (emphasis added). Thus the Court considered only whether the variable annuities were "insurance," not whether they qualified under the Securities Act exemption for annuities.

[16] The Court described the alleged "mortality risk" as follows:

> Each issuer [of the variable annuities] assumes the risk of mortality from the moment the contract is issued. That risk is an actuarial prognostication that a certain number of annuitants will survive to specified ages. Even if a substantial number

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this "mortality risk" element did *not*, however, make the variable annuities "insurance": "The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. *Yet it is apparent, not real; superficial, not substantial.*" *Id.* at 71 (emphasis added). The Court emphasized that since the variable annuities did not involve any fixed return, all the investment risk remained with the annuitant, not the issuer. Thus there was "no true risk in the insurance sense. . . . There is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage." *Id.* at 71-73.

The *VALIC* Court clung to a stricter definition of "insurance" than the one proposed by the Securities and Exchange Commission. The Court noted that the annuity contracts did have "one true insurance feature," since they provided life insurance to insurable applicants 60 years of age or younger on a decreasing basis for five years. Nonetheless, the Court found that even this true insurance feature was "ancillary and secondary to the annuity feature" and thus did not turn the annuities into "insurance." *Id.* at 72 n.15. Although the *VALIC* Court did mention "mortality risk" in the sense that today's majority relies upon, the issue at stake was not this risk, but the necessity of financial risk-taking on the part of the insurance company. The variable annuities imposed little economic risk on the issuing insurance companies, since the return on the annuity simply varied with the success of the insurance companies' investments. *Id.* at 69-70. This led the Court to find that the annuities at issue were not "insurance." The *VALIC* Court did not

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[16] *continued*

> live beyond their predicted demise, the company issuing the annuity—whether it be fixed or variable—is obligated to make the annuity payments on the basis of the mortality prediction reflected in the contract. This is the mortality risk . . . .

VALIC, 359 U.S. at 70.

offer a general definition of "insurance," noting instead that it "would not undertake to freeze" the concepts of "insurance" and "annuity" according to their meaning at the time the federal statutes were passed.[17] *Id.* at 71. It simply emphasized that "insurance" must involve some economic risk-taking on the part of the insurance company. *Id.*

In more recent cases the Supreme Court has continued to emphasize that the risk transferred by "insurance" must be an *insurance* type risk, not just any old risk: "Both the 'spreading' and the 'underwriting' of risk refer in this context to the transfer of risk *characteristic of insurance*." *Pireno*, 458 U.S. 119, 130 (1982) (emphasis added). In addition, the *Royal Drug* Court, while discussing the risk-spreading characteristic of insurance, cited the Webster's New International Dictionary definition of "insurance," which states that insurance must protect against "loss or damage by a contingent event" or by a "specified contingency or peril." 440 U.S. 205, 211 n.7 (1979); *see supra* section II for full text of Webster's definition.

As the treatises and definitions discussed in section II reveal, we define "the business of insurance" too broadly if we fail to recognize the necessary connection to a contingent event or peril. Although the Supreme Court

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[17] Despite the Supreme Court's expressed intent not to provide a comprehensive definition of "insurance" in *VALIC*, the majority attempts to find in this decision a formula for "insurance," i.e., insurance = mortality risk + guaranteed return. *See supra* p. 12. In addition, the *VALIC* Court specifically rejected the claim that the "risk of declining returns in times of depression" qualified as the necessary "risk in the insurance sense." 359 U.S. at 71. The Court noted, "We deal with a more conventional concept of risk-bearing when we speak of 'insurance.' " *Id.* Thus the majority's reference to a "decline in the market," *see supra* p. 13, as a "risk" that the Retirement CD protects against, cannot possibly qualify as an "insurance risk" that makes the CD "insurance." Furthermore, with the possible exception of the stock market crash of 1929, "a decline in the market" generally does not qualify as "a single, contingent event," as suggested by the majority. *Id.*

has not yet had to focus on this necessity, since it did not impact the cases considered, the definition quoted in *Royal Drug*, along with the modern Court's repeated reliance on sources like Webster's, Couch, and Appleman & Appleman for addressing definitional questions in the insurance realm, *see supra* section II, strongly suggest that the Court would recognize that "insurance" under McCarran-Ferguson requires that coverage commence only with the happening of a contingent event or specified peril. Annuities, such as the Retirement CD, do not possess this characteristic, and thus cannot qualify as "insurance."

It should be emphasized in the context of the current discussion that none of the Supreme Court cases dealing with McCarran-Ferguson (or other insurance issues) have been about the power of states to regulate the selling of annuities as insurance. In fact, the cases cited by both sides have almost all involved attempted regulation of state-licensed insurance companies under federal securities and antitrust laws, rather than the regulation of federal entities under state insurance codes. The issues at stake in the Supreme Court's "insurance cases"[18] fall into three basic categories: 1) whether a particular state *statute* was enacted "for the purpose of regulating the business of insurance" under McCarran-Ferguson, thus preempting an overlapping federal statute, *see United States Dep't of the Treasury v. Fabe*, 113 S. Ct. 2202 (1993) (holding that state insolvent insurance company statute giving claims by United States fifth priority, while federal bankruptcy statute would give them first, escapes federal preemption to extent that it protects policyholders and covers admin-

[18] The Supreme Court's recent decision in *Barnett Bank*, 116 S. Ct. 1103, is truly both an insurance case and a banking case, since it involves the power of national banks to sell insurance in small towns, despite state statutes to the contrary. *See supra* n.1. Because the focus of the case is on the express authority granted by the National Bank Act—which fits within McCarran-Ferguson's exception to state law preemption—rather than on whether the national banks were selling "insurance" (they clearly were), I treat *Barnett Bank* in Section IV.

istrative costs); *Securities and Exchange Comm'n v. National Securities, Inc.*, 393 U.S. 453 (1969) (holding that state law aimed at protecting insurance company *shareholders*, rather than *policyholders*, not enacted for purpose of regulating "the business of insurance"); 2) whether a particular *practice* by an insurance company relates to "the business of insurance," such that the McCarran-Ferguson *antitrust* exemption applies,[19] *see Pireno*, 458 U.S. 119 (1982) (holding that insurance company use of "peer review" process to determine coverage for submitted claims does not constitute "the business of insurance"); *Royal Drug*, 440 U.S. 205 (1979) (holding that insurance company "Pharmacy Agreements" providing for $2 prescription drugs at participating pharmacies do not constitute "the business of insurance," since agreements made with pharmacies rather than policyholders); and 3) whether a particular product sold by an insurance company falls within the exemption for insurance policies and annuity contracts under the *Securities Act*,[20] *see United Benefit*,

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[19] McCarran-Ferguson exempts the business of insurance from federal antitrust law when that business is already regulated by state law:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, . . . the Sherman Act, . . . the Clayton Act, and the . . . Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

15 U.S.C. § 1012(b).

[20] The relevant section exempts the following from the Securities Act of 1933: "Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia." 15 U.S.C. § 77c(a)(8). The fact that the Securities Act exempts annuities and insurance *separately* exemplifies a Congressional recognition of their distinct nature.

387 U.S. 202 (1967) (holding that deferred annuity contract not exempt because it is essentially "investment contract" during accumulation phase); *see also VALIC*, 359 U.S. 65 (1959) (discussed above).[21]

Recognizing the scope of the insurance cases considered by the Supreme Court thus far, and how the focus of these cases differs from the one at hand, serves to demonstrate the limitations of these cases for deciding the issue before us. In particular, the three-part test cited by the majority for determining what constitutes "the business of insurance" under McCarran-Ferguson, *see supra* p. 6, has an impressive pedigree of Supreme Court endorsement, yet proves largely inappropriate and unhelpful to answering the question now before us. The three criteria first evolved

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[21] The Seventh Circuit cases are in accord. In *N.A.A.C.P. v. American Family Mut. Ins. Co.*, 978 F.2d 287 (1992), we considered application of the federal Fair Housing Act to the insurance industry practice of "redlining"—charging higher rates or declining to write insurance for people who live in particular geographic areas. We held that even though the FHA did not "specifically relate[ ] to the business of insurance," so as to avoid McCarran-Ferguson preemption by state law (i.e., reverse preemption), the FHA did not in any way conflict with or displace a state insurance law. Thus we allowed the practice of redlining to be challenged under the FHA. We noted, however, that "[i]f Wisconsin wants to authorize redlining, it need only say so; if it does, any challenge to that practice under the auspices of the Fair Housing Act becomes untenable." *Id.* at 297. Our decision in *Associates in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561 (7th Cir. 1991), fits more easily into the categories noted in the text, specifically category three. We "held that the "Flexible Annuity" at issue did qualify as an annuity, such that it was exempt from the registration requirements of the Securities Act. Although we mentioned in dicta that "[a]nnuities sometimes contain an element of insurance" (since the longer the purchaser lives, the more the seller has to pay), *id.* at 565, we did not equate annuities and life insurance. And since the Securities Act provides *separate* exemptions for annuities and insurance, we did not have any reason to consider whether the annuity at issue could fairly be called "insurance."

in the *Royal Drug* case and were later summarized by the Court in *Pireno* as follows:

> *first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry.

458 U.S. at 129. Moreover, the Court recently reaffirmed this "tripartite standard for divining what constitutes the 'business of insurance.' " *Fabe*, 113 S. Ct. at 2206 (citing *Pireno*).[22] Unfortunately, this test arose in the context of cases considering the activities of *insurance companies*. All three criteria, and particularly the second criterion, appear directed at examining an insurance company practice—not a practice by a non-insurance company that may arguably be termed "the business of insurance." The Retirement CD, at least on its face, does not involve "policyholders," a "policy relationship," an "insurer," or an "insured." And as for the third criterion, it simply restates the very question before us: should the selling of this particular product be *limited* to entities within the

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[22] The majority rightly notes that the *Fabe* Court recognized that this test developed in two cases where the issue at stake was whether the *antitrust* exemption of McCarran-Ferguson applied. The *Fabe* Court intimated that the category of "laws enacted for the purpose of regulating the business of insurance" (the first clause of § 1012(b), and the one at stake in *Fabe*) "necessarily encompasses more than just 'the business of insurance' " (the second clause of § 1012(b), and the one at stake in *Royal Drug* and *Pireno*). 113 S. Ct. at 2210. Any such distinction in scope between the two clauses would not affect this case, however, since there is no question that the Illinois Insurance Code is a law enacted for the purpose of regulating the business of insurance. The only question here is whether Illinois is allowed to apply its insurance code to national banks by calling their offering of an annuity product "the business of insurance."

insurance industry?[23] The most relevant part of the test is the first criterion—whether the practice has the effect of transferring or spreading a policyholder's risk—but it alone cannot be decisive.

Two additional points demonstrate the limitation of the Supreme Court's pre-*NationsBank* McCarran-Ferguson jurisprudence for addressing the question now before us. First, the Court's stated approach to understanding the scope of McCarran-Ferguson reveals that it has always been considering *insurance company* practices. Since 1969 the Supreme Court has steadfastly asserted that the focus of McCarran-Ferguson is on "the relationship between the insurance company and the policyholder." *National Securities*, 393 U.S. 453, 460 (1969); *Royal Drug*, 440 U.S. at 216; *Pireno*, 458 U.S. at 128; *Fabe*, 113 S. Ct. at 2208. Obviously, such a focus falls short in the case at hand, as there is no such "relationship" to protect. The Retirement CD relationship involves no insurance companies and arguably no "policyholders." Similarly, the Court has sometimes emphasized that the McCarran-Ferguson "reverse preemption" doctrine is directed at "the 'business of insurance' and not the 'business of insurance companies.' " *Royal Drug*, 440 U.S. at 217; *Pireno*, 458 U.S. at 129 (quoting *Royal Drug*); *National Securities*, 393 U.S. at 459-60 ("Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the 'business of insurance' does [McCarran-Ferguson] apply."). In these cases the Court has recognized limitations on the federal preemption exemption under McCarran-Ferguson, noting that certain activities of insurance companies *remain* subject to federal

[23] If the import of the third criterion is to ask the *empirical* question of whether the practice at issue has been limited to entities within the insurance industry, rather than the regulatory question of whether the practice has been legally restricted to only the insurance industry, the answer for annuities is that other entities have historically issued them, particularly charitable organizations and non-profit institutions.

law (i.e., that certain insurance company activities do not constitute "the business of insurance").[24] The Court has not yet considered a case, however, where a state properly regulated the conduct of a non-insurance company under its McCarran-Ferguson power to regulate "the business of insurance."[25]

IV. State Regulation of National Banks

Since the infancy of our nation and by way of some of the most noted Supreme Court decisions in our history, national banks have been protected from intrusive regulation by the states.[26] Thus if we conclude, as the major-

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[24] The *National Securities* Court also recognized the danger of attempting to rely on the legislative history of McCarran-Ferguson to unravel the significance of the phrase "the business of insurance." The Court noted that "Congress was mainly concerned with the relationship between insurance ratemaking and the antitrust laws, and with the power of the States to tax insurance companies." 393 U.S. at 458-59. The Court concluded, "The debates centered on these issues, and the Committee reports shed little light on the meaning of the words 'business of insurance.'" *Id.* at 459. The report referred to by the majority, *see supra* p. 15, is consistent with the Supreme Court's observation, as it sheds little light on the critical issue. In fact, the entire legislative history contains not a single reference to "annuities" by any member of Congress or any witness during the debates and testimony which resulted in the Act.

[25] In the only case to raise the issue, the state insurance law was found to be preempted by a specific provision in the National Bank Act—a provision fitting within McCarran-Ferguson's express exception to state control of "the business of insurance," where a federal statute "specifically relates" to that business. *See Barnett Bank*, 116 S. Ct. 1103 (discussed *infra*). Thus there was no true conflict between McCarran-Ferguson's grant of limited insurance sovereignty to the states and the power granted national banks to sell insurance in small towns.

[26] *See, e.g., M'Cullough v. Maryland*, 17 U.S. (4 Wheat.) 316, 435-37 (1819) (rejecting state power to tax national bank and focussing on national banks as instruments of supreme national government that states have no power to "retard, impede, burden, or in any

(Footnote continued on following page)

ity does, that McCarran-Ferguson allows the State of Illinois to regulate the selling of annuities by national banks, we must then consider whether McCarran-Ferguson trumps the countervailing federal principle, enshrined in the National Bank Act, that the banking activities of national banks are governed by federal law and generally should not be interfered with by the states. This principle was just reaffirmed by the Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson*, 116 S. Ct. 1103, 1108 (1996), where the Court referred to our history of national bank legislation as follows: "That history is one of interpreting grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law." Thus the majority's interpretation of "the business of insurance" poses a conflict not merely between state law and federal law (which in the McCarran-Ferguson context would usually allow state law to prevail), but between two overriding principles of federal law: the supremacy of the federal government in regulating national banks (the National Bank Act) and the presumed autonomy of the states in regulating the business of insurance (McCarran-Ferguson).

The tradition against allowing state intrusion into the activities of national banks is a long and lofty one. In *Easton v. Iowa*, 188 U.S. 220, 229 (1903), the Supreme Court recognized that "[t]he principles enunciated in *M'Cullough v. Maryland* . . . and in *Osborn v. Bank of United States* . . . , though expressed in respect to banks incorporated directly by acts of Congress, are yet applicable to the later and present system of national banks." The *Easton* Court was considering an attempt by Iowa to apply their state banking statute, which forbid the receipt of deposits

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[26] *continued*

manner control"); *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 860 (1824) (reaffirming principles of *M'Cullough* and noting that national banks are "created for public and national purposes").

by insolvent banks, to a national bank. While it did not question the wisdom of such a statute or suggest that it was being applied unevenly within Iowa, the Court soundly rejected the state's attempt to apply it to a national bank. The *Easton* Court emphasized the public, independent, and national character of the national bank system, *id.* at 229-30, and concluded that "[s]uch being the nature of these national institutions, it must be obvious that *their operations cannot be limited or controlled by state legislation* . . . ." *Id.* at 230 (emphasis added).

In regard to the policy arguments made by the State of Iowa regarding the importance of protecting bank customers—which parallel the consumer protection arguments made by the State of Illinois in the present case—the *Easton* Court's response was two-fold. First, the Court noted that national banks are regulated by federal law and that these provisions do seek to protect the depositors and creditors of national banks from fraudulent banking. *Id.* at 230. Second, in response to the Iowa Attorney General's suggestion that the state provisions were valuable for holding the banks to a "higher degree of diligence," which in turn would "give[ ] the general public greater confidence in the stability and solvency of national banks," *id.* at 231, the Court simply relied on the absence of Congressional intent to allow such extra protection:

> [W]e are unable to perceive that Congress intended to leave the field open for the states to attempt to promote the welfare and stability of national banks by direct legislation. If they had such power it would have to be exercised and limited by their own discretion, and confusion would necessarily result from control possessed and exercised by two independent authorities.

Id. at 231-32. Our answer to the consumer protection arguments of Illinois should be of a piece. If Congress has not allowed for such state control of these national bank activities, it is no response to say (as Illinois does) that the state can better protect customers than the Comptroller of the Currency can. The issue is one of authority

and power, not competency and expertise. The *Easton* Court concluded that "it is not competent for state legislatures to interfere, whether with hostile or friendly intentions, with national banks or their officers in the exercise of the powers bestowed upon them by the general government." *Id.* at 238.

In *First National Bank of San Jose v. California*, 262 U.S. 366 (1923) (hereinafter *San Jose*), the Court relied upon themes similar to those in *Easton*. While rejecting an attempt by the State of California to apply its escheat law (providing that unclaimed deposits in bank accounts inactive for more than twenty years would escheat to the state) to a national bank, the Court noted that national banks "are instrumentalities of the federal government." *Id.* at 368. The *San Jose* Court emphasized that "any attempt by a state to define their duties or control the conduct of their affairs is void, whenever it conflicts with the laws of the United States or frustrates the purpose of the national legislation, or impairs the efficiency of the bank to discharge the duties for which it was created." *Id.* at 369. In particular the Court noted: "Plainly, no state may prohibit national banks from accepting deposits, or directly impair their efficiency in this regard." *Id.* Such state regulation would "seem incompatible with the purpose to establish a system of governmental agencies specifically empowered and expected freely to accept deposits from customers irrespective of domicile . . . ." *Id.* at 370. The *San Jose* Court concluded by citing a long list of cases, including *M'Cullough v. Maryland*, *Osborn v. Bank of the United States*, *Easton*, and others, as support for the statement that it had "often pointed out the necessity for protecting federal agencies against interference by state legislation." *Id.*

Over thirty years later, in *Franklin National Bank v. New York*, 347 U.S. 373 (1954), the Court continued to emphasize the sovereignty of national banks in their authority to receive deposits unimpeded by state regulations. This time the Court rejected the State of New York's attempt to apply to national banks an advertising statute

that prohibited use of the word "savings" in bank names and advertising. The Court noted that "The National Bank Act authorizes national banks to receive deposits without qualification or limitation, and it provides that they shall possess 'all such incidental powers as shall be necessary to carry on the business of banking . . . .'" *Id.* at 376. The Court found that modern competition for banking business necessitated the use of advertising, but could see "no indication that Congress intended to make this phase of national banking subject to local restrictions." *Id.* at 378. Thus it determined that there was "a clear conflict" between the freedom to advertise under federal law and the restrictions of New York law that had to be resolved in favor of federal law "as a matter of supremacy." *Id.* at 378-79. "However wise or needful [the state] policy, . . . it must give way to the contrary federal policy." *Id.* at 379.

The Court has never retreated from its insistence that state laws not be allowed to interfere with the federally authorized activities of national banks, particularly in regard to specifically authorized activities like the taking of deposits. Even in *First National Bank in Plant City, Fla. v. Dickinson*, 396 U.S. 122 (1969) (hereinafter *Plant City*), where the Court did allow the application of a Florida branch banking statute to national banks in the state, the Court maintained that "Congress has absolute authority over national banks." *Id.* at 131. The difference in *Plant City* was that the national statute on branch banks *incorporated* state law as to "when, where, and how" any bank branch office could be operated. *Id.* at 130 (citing the McFadden Act, 12 U.S.C. § 36(c)). Even the parties in *Plant City* agreed that the McFadden Act permitted national banks to have branch offices "if and only if the host State [would] permit one of its own banks to branch." *Id.* Thus allowing application of the state branch bank statute to national banks in Florida did not in any way undermine the Supreme Court's established jurisprudence regarding the supremacy and independence of national banks.

Just this term in *Barnett Bank*, the Supreme Court invoked the decisions in *Easton*, *San Jose*, and *Franklin National Bank* to emphasize that the history of national bank jurisprudence has been one of reading national bank powers broadly and minimizing state interference with the exercise of these powers. 116 S. Ct. at 1108-09. The Court concluded, "In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted." *Id.* at 1109. The Court noted that this leaves some room for state regulation, at least when it does not prevent or significantly impair the exercise of national bank powers.[27] *Id.* In particular, the *Barnett Bank* Court recognized that when a federal banking statute explicitly provides for state law oversight, as in the *Plant City* case, consistent state regulation is allowed. *Id.* (citing *Plant City*). The *Barnett Bank* Court emphasized, however, that "where Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies." *Id.* (citing *Franklin National Bank*, 347 U.S. at 378, n.7 [listing examples], for principle that where Congress intends to subject national banks to local restrictions, it does so expressly).[28]

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[27] As explained *infra*, there is little doubt that the issuing of the Retirement CD falls within the express powers of national banks (since the Comptroller of the Currency says that it does and the conclusion is a reasonable one); nor is there any doubt that Illinois intends to significantly interfere with this activity, since it wants to forbid it entirely.

[28] Even the appellee does not contend that Congress expressly conditioned exercise of the National Bank Act powers to accept deposits, enter into contracts, incur liabilities, and fund bank operations—i.e., the powers under which the Retirement CD has been authorized by the Comptroller of the Currency, *see infra*—upon compliance with additional state regulation.

The majority seems to read *Barnett Bank* as making some kind of broad statement that McCarran-Ferguson normally trumps the National Bank Act. *See supra* p. 17 ("*Barnett Bank* demonstrates that the Bank Act possesses no unique immunity from the McCarran-Ferguson Act."). Yet *Barnett Bank* contains no such message or suggestion. *Barnett Bank* involved a *convergence*, rather than a conflict, between the National Bank Act and McCarran-Ferguson; thus there was no need to consider which statute would control. The Court simply recognized that McCarran-Ferguson itself allows for federal law to preempt state insurance law when the federal statute "specifically relates to the business of insurance."[29] 116 S. Ct. at 1106 (citing McCarran-Ferguson, 15 U.S.C. § 1012(b)). And since the federal banking provision at issue, 12 U.S.C. § 92, specifically provides for the sale of insurance by national banks in small towns, the Court found that this statute fit neatly within the McCarran-Ferguson exception to state supremacy over "the business of insurance." *Id.* at 1111 ("[U]sing ordinary English, one would say that this statute specifically relates to the '*business of insurance.*' ") (emphasis in original). *Barnett Bank* was about

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[29] I fully agree with the majority that this provision of McCarran-Ferguson was designed "to protect state [insurance] regulation primarily against *inadvertent* federal intrusion." *Supra* p. 17 (quoting *Barnett Bank*, 116 S. Ct. at 1112 (emphasis in original)). The history of McCarran-Ferguson clearly indicates that Congress passed the Act in order to protect state control of the insurance industry against unintentional interference by broad federal statutes, particularly the antitrust laws. *See Barnett Bank*, 116 S. Ct. at 1112 (reviewing history). The National Bank Act, however, is not such a statute; and my analysis does not by any means suggest "applying" it to the insurance industry. The majority's suggestion, *supra* p. 17, that protecting national banks who want to sell the Retirement CD from state law prohibition of this activity is "exactly the intrusion" that the *Barnett Bank* Court warned against, does not accurately reflect either the history of McCarran-Ferguson or the nature of our inquiry in the case at hand. This case is about state intrusion into federal banking business, not about federal intrusion into state control of the insurance business.

the meaning of "specifically relates," not the meaning of "the business of insurance"—no one contested that the national banks desired to sell insurance. As such, it provides no aid in answering the fundamental question in the case at hand: whether national banks selling annuities like the Retirement CD are engaged in "the business of insurance."[30] *Barnett Bank's* primary relevance for our inquiry is its strong affirmation of the presumed power of national banks to engage in banking activities free from state interference.

Neither the majority nor the appellee have provided any reason for retreating from the Supreme Court's endorsed stance of robust protection of national banks from state interference with their banking activities. In fact, neither the majority nor the appellee even addresses this weighty issue.[31] But it is an issue that cannot simply be ignored.

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[30] The majority portrays my position as being "that the activities of national banks are simply not subject to state interference, regardless of the McCarran-Ferguson Act." *Supra* p. 17. I maintain no such thing. For example, I have no doubt that, were it not for Section 92, the states could forbid national banks to sell insurance in small towns or that the states can now forbid national banks to sell (pure) insurance in towns over 5000 people. Where a national bank is clearly engaged in non-banking, insurance activities, which are not specifically authorized by Congress, McCarran-Ferguson does seem to allow state regulation, even to the point of prohibition. The difficulty of this case is that Illinois wants to regulate as insurance what the Comptroller of the Currency has found to be banking. *See infra.*

[31] While the issue of national bank supremacy seems to arise rather infrequently in this circuit, we have previously recognized the import of the issue. In *American Sur. Co. of New York v. Baldwin*, 90 F.2d 708 (7th Cir. 1937), we stated as follows:

> National banks are instrumentalities of the federal government created for a public purpose, and, as such, necessarily, subject to the paramount authority of the United States. Any attempt by a state to define their duties or to control the conduct of their affairs is void if it conflicts with the laws of the national government and either frustrates the purpose of the

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If we are to approve Illinois's current attempt to regulate the national bank activity at issue, we should do so explicitly and only after consideration of the long and weighty tradition against allowing state intrusion into the federally authorized activities of a national bank, particularly the taking of deposits. Under my approach to the "business of insurance" question under McCarran-Ferguson, we need not address the daunting issue of a state regulating the national bank activity of issuing the Retirement CD. Since Illinois would have no McCarran-Ferguson authority to regulate the activity as "the business of insurance," we would not have to consider whether this state regulation accorded with the national and independent nature of national banks.

The only seeming escape from this quandary for the majority and the appellee would be a conclusion that the offering of the Retirement CD is not truly a *banking* activity authorized by the National Bank Act. For purposes of its analysis, the majority assumes that the appellant national banks are authorized to sell the Retirement CD under federal law. *See supra* p. 4. But I would like to conclude by going one step further, particularly since leaving open the possibility that this activity is *not* authorized by federal law could invite speculation that the immediately preceding analysis is irrelevant to the case at hand.

The Supreme Court in *NationsBank* has recently reminded us that the Comptroller of the Currency has been "charged by Congress with superintendence of national

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[31] *continued*

> federal legislation, or impairs the efficiency of these agencies of the government to discharge the duties for the performance of which they are created.

Id. at 709. Such a conclusion of law does not wither and die simply because it has not been relied upon for a long span of years—at least not without explanation of the cause and circumstances of its demise.

banks" and is "the administrator charged with supervision of the National Bank Act . . . [who] bears primary responsibility for surveillance of 'the business of banking.' " 115 S. Ct. 810, 812, 813 (1995). The Court emphasized the great deference to be accorded "to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute." *Id.* at 813 (quoting *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 403-404 (1987)). The *NationsBank* Court set forth in bold terms the rule for evaluating the determination of an administrator in interpreting the statute with which he or she has been entrusted: "If the administrator's reading fills a gap or *defines a term* in a way that is reasonable in light of the legislature's revealed design, we give the administrator's judgment 'controlling weight.' " *Id.* at 813-14 (emphasis added) (citing *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984)). Thus we are required to view the Comptroller of the Currency's interpretation of the National Bank Act through a very deferential lens.

On May 12, 1994, the Office of the Comptroller of the Currency ("OCC") issued a letter to Blackfeet National Bank stating that it had "no objection to a national bank marketing [the] Retirement CD," subject to the safety and soundness conditions set forth in the letter. The OCC looked to the powers given national banks under 12 U.S.C. § 24 (Third and Seventh) and concluded that "the *express authorizations* for the Bank to receive deposits and enter into contracts, coupled with its powers to incur liabilities and fund its operations, clearly make the Retirement CD *an authorized Bank activity*" (emphasis added).[32] In fact,

[32] Subsequently, the Federal Deposit Insurance Corporation (FDIC) has also concluded that the Retirement CD is a "deposit" under the terms of the Federal Deposit Insurance Act, 12 U.S.C. § 1813(l). The FDIC termed the Retirement CD a "hybrid CD," which would be insured by the FDIC like other bank deposits, up to a maximum of $100,000. The only special limitation on FDIC coverage is that annuity payments exceeding the value of the

(Footnote continued on following page)

the OCC repeatedly emphasized that the power to sell the Retirement CD was not merely an "incidental" or "useful" aspect of the business of banking: "The product represents the very essence of banking which is embodied in a bank's express authority to accept deposits and enter into contracts, and authority to incur liabilities and fund its operations."[33]

The OCC noted that "the inherent relationship that the Retirement CD customer has with the [issuing national bank] is that of depositor or creditor." The OCC rejected the contention that the life-based payment structure of the CD made its issue any less sanctioned as an expressly authorized national bank activity: "The fact that the product is structured to provide for interest payments keyed in part to the expected life of the depositor does not change the intrinsic nature of the Retirement CD as an authorized bank product." The OCC did condition its approval of the CD, however, on full compliance with seventeen listed conditions, which were directed to ensuring the safety of the product, the soundness of the issuing

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[32] *continued*

Retirement CD at the maturity date would not be federally insured, i.e., if the issuing bank failed while the holder of the Retirement CD was still living, but after the total of the annuity disbursements exceeded the account balance as of the maturity date, the FDIC would not continue making the annuity payments. The FDIC insisted that banks issuing the Retirement CD make this restriction clear to potential purchasers, and the OCC has asserted that it will monitor compliance with this requirement.

[33] The OCC also stated:

> The Retirement CD is clearly a financial product whose primary attributes are grounded in the Bank's expressly authorized powers. While somewhat novel in its approach to determining the interest on deposited funds by providing customers, inter alia, with a fixed periodic lifetime payment, the Retirement CD nonetheless represents fundamentally a bank authorized product.

bank, and the provision of complete, accurate information to would-be purchasers.[34]

In subsequent, detailed letters to senators on the Committee on Banking, Housing, and Urban Affairs, the Comptroller of the Currency stood by the position taken by his office regarding authorization of the Retirement CD as a bank product. The senators had apparently expressed concerns about the safety of the CD and its nature as a national bank product. In his August 18, 1994 letter to Senator Alfonse D'Amato, the Comptroller of the Currency, Eugene A. Lewis, emphasized that his office had been fully informed of and fully understood the structure of the Retirement CD. He reiterated the earlier legal conclusion issued by his office that national banks were expressly authorized under federal law to issue the CD. He also explained that the OCC did not issue a "formal approval" of the product, and that none was needed for its sale,

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[34] For example, the OCC insisted that any issuing national bank take steps to protect itself against the risk of having to make lifetime annuity payments surpassing the value of the invested capital and accrued interest (when a purchaser lives longer than expected). Any issuing bank was required to develop a detailed plan for mitigating this risk, possibly through the purchase of commercially available annuities. Other conditions were designed to address matters such as the financial stability of the issuing banks, accurate accounting, and implementation of adequate product control systems. In addition, the OCC required that an opinion on the FDIC insured status of the CD be obtained and that potential customers be accurately informed of the meaning and significance of the FDIC's determination. The OCC also addressed specific language within the Retirement CD promotional materials, such as use of the term "guaranteed," to ensure that customers not be misled. Many additional conditions were directed to ensuring that potential purchasers are given clear, complete, and accurate information regarding the features and risks of the CD. The OCC even required that any issuing banks implement a special training program for all bank personnel who would be involved in the marketing of the CD, as well as a monitoring system to ensure compliance with the OCC conditions and other applicable laws and to handle customer complaints.

"[b]ecause offering the Retirement CD lies within the business of banking." Thus the Comptroller himself rejected the argument (asserted by the appellee in this case) that the issuance of the "no objection" letter, rather than a "formal approval" letter, somehow indicated that the Comptroller had reservations about the CD.

In his letter to D'Amato, the Comptroller addressed concerns that had been expressed about consumer protection, regulatory issues, safety and soundness, and competitive equality with insurance companies. The Comptroller explained the consumer protection and disclosure provisions upon which issuance of the Retirement CD was conditioned. He expressed confidence about the OCC's ability to monitor the Retirement CD: "We believe the OCC has the expertise fully to examine and evaluate Bank practices to mitigate the risks associated with the Retirement CD." He concluded:

> We believe these steps adequately and responsibly address the supervisory concerns you have expressed with the payment risks associated with the Retirement CD. As with any bank product, we will continue to review the Bank's implementation of these procedures and evaluate the Bank's effectiveness in dealing with the risks associated with the product. Should we determine at any point that the Bank is materially not in compliance with these requirements, we would direct it to cease offering the product until it took appropriate corrective actions.

In regard to the insurance company competitors who had expressed concerns that the CD would give national banks a "competitive advantage" over annuity products offered by insurance companies, the Comptroller appropriately responded that "the potential for competitive implications does not affect the Bank's legal authority to offer the product." In addition, the Comptroller properly abstained from commenting on the potential applicability of state

insurance laws to the Retirement CD,[35] since any such application would likely vary from state to state and was beyond his expertise and authority to determine.

The Comptroller's October 11, 1994 letter to Senator Donald Riegle, Chairman of the Committee on Banking, Housing, and Urban Affairs, addressed many of the same issues covered in the letter to Senator D'Amato, as well as some additional points raised in a letter received from Senator Riegle. The Comptroller again expressed confidence in the OCC's ability to monitor the offering of the Retirement CD and its commitment to ensuring that disclosures to potential customers were clear, simple, and complete. In addition, the Comptroller stated that Blackfeet National Bank had not commenced offering the CD, since it had not yet complied with all seventeen conditions imposed by the OCC in its no objection letter.

There can be little doubt that the Comptroller of the Currency has authorized offering of the Retirement CD by national banks. In so doing, he has defined terms in the National Bank Act, such as the "taking of deposits," to include the sale of this product; and he has emphasized that national banks have the power to offer the Retirement CD as part of their *express* powers under the National Bank Act. No one has provided this court with any

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[35] He wrote:

> Our legal analysis and conclusions to date have been limited to a determination of the Bank's authority to conduct the business of banking under the National Bank Act. State regulatory officials may conclude that state insurance laws also apply to the Retirement CD or any other activity which we interpret as being authorized by the National Bank Act. Such a conclusion, however, does not affect our interpretation of that Act. The applicability of any particular state law to the Retirement CD will have to be reviewed on a case by case basis.

The appellee's attempt to read into this statement some kind of concession by the Comptroller that state insurance laws *will* apply ignores the plain language of the statement. The Comptroller's position was simple: no comment.

reason, and I do not myself know of one, to conclude that the Comptroller's conclusion is not a "reasonable construction" of the National Bank Act. Because the Comptroller's interpretation of the National Bank Act, regarding authorization of the Retirement CD as a national bank product, involves the definition of terms within the Act and is reasonable in light of the revealed design of the Act, it is entitled to controlling weight. Thus it cannot be seriously questioned that national banks selling the Retirement CD are engaged in a banking activity. While I believe that we should not reach this issue—since I think we should reject Illinois's attempt to regulate the sale of the Retirement CD outright—if we resolve the case as the majority does, we cannot avoid the resulting conflict between federal banking law and state insurance law. I do not think we can authorize Illinois to regulate (and potentially forbid) the sale of the Retirement CD by national banks in its territory without confronting the federalism and national supremacy issues that are raised by such regulation. Neither the majority nor the appellee has provided legal authority for the proposition that a state can regulate as "the business of insurance" an activity by a national bank that the Comptroller of the Currency has specifically found to be "the business of banking." If we are ultimately to condone such a direct state intrusion into the authorized activities of a national bank, we should do so only after explicitly addressing the legal quandary at stake. The majority's conclusion that a national bank issuing an annuity is engaged in "the business of insurance" is only half the battle.

After considering the full import of the Supreme Court's unanimous decision in *NationsBank*, 115 S. Ct. 810 (1995), I simply cannot accept the majority's conclusion that the selling of an annuity by a national bank constitutes "the business of insurance" under McCarran-Ferguson. While the *NationsBank* opinion did not address the precise question before us, its analysis, its tone, and the sources relied upon all compel the inference that annuities are *not* truly "insurance," and thus that a national bank selling them

is not engaged in "the business of insurance." The modern literature on insurance powerfully affirms this conclusion, and the history of insurance caselaw is in accord. In addition, the long and established tradition against allowing state intrusion into the affairs of national banks cautions against too readily condoning the present regulation by the State of Illinois. If we are going to sanction the current state intrusion into national bank activities—activities specifically approved by the Comptroller of the Currency as being "the business of banking"—we should do so only after substantial hesitation and explicit consideration.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

OPINION OF MAGISTRATE JUDGE IN THE DISTRICT COURT 887 F. Supp. 1066 (N.D. Ill. 1995)

AMERICAN DEPOSIT CORPORATION, and BLACKFEET NATIONAL BANK, Plaintiffs, vs. JAMES W. SCHACHT, individually and as Acting Director of Insurance of the State of Illinois, Defendant.

No. 95 C 207

EDWARD A. BOBRICK, U.S. Magistrate Judge: Before the court are the cross-motions of plaintiffs American Deposit Corp. ("ADC") and Blackfeet National Bank, ("Blackfeet"), and defendant James W. Schacht, Acting Director of Insurance of the State of Illinois, ("Schacht"), for summary judgment. The American Council of Life Insurance ("ACLI") and the National Association of Life Underwriters ("NALU") have filed briefs as amici curiae.

I. BACKGROUND

ADC has developed a new investment vehicle, referred to as a Retirement Certificate of Deposit ("Retirement CD"), which, while having traditional features of a certificate of deposit, also contains terms and features of an annuity. (Complaint at 20-22). ADC licensed the Retirement CD, for offering and sale, to Blackfeet, a National Banking Association organized and operated pursuant to the National Bank Act, Title 12 U.S.C. § 21 et seq ("Bank Act").

In 1994, Blackfeet began to market the Retirement CD, in a rather limited fashion, in Illinois by sending informational packets to ten persons who requested them. Blackfeet did not, and has not, accepted any deposits from Illinois residents. Since the Retirement CD had

annuity-like features ordinarily associated with life insurance, Schacht issued a cease and desist order against Blackfeet and ADC, and scheduled a hearing to investigate whether Blackfeet and ADC were engaging in insurance activities subject to state regulation. ADC and Blackfeet, in response to Schacht's order, filed a complaint on January 11, 1995, seeking injunctive and declaratory relief against Schacht. The Complaint contends that the Bank Act authorizes the offering of the Retirement CD, and that the Supremacy Clause and the Dormant Commerce Clause prohibit Schacht's actions to regulate the offering of the Retirement CD. Both parties have filed motions for summary judgment in this case, essentially asking the court to determine whether the Retirement CD is an insurance-type instrument subject to state regulation or a certificate of deposit which, under the Bank Act, would be outside state regulation. The parties have filed the requisite statements of undisputed facts under Local Rule 12, but this case really turns on the characterization of the Retirement CD under applicable law.[1] Accordingly, we begin our analysis with an outline of the statutory framework the parties have placed in issue, and then review the terms of the Retirement CD along with the characterizations of the instrument the parties have offered.

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[1] Indeed, were we to treat this as a normal motion for summary judgment, Schacht's motion could readily be denied. Under Local Rule 12(m)(3), a party moving for summary judgment must submit a statement that includes the facts that the moving party contends entitle it to judgment. Review of Schacht's submission fails to reveal an allegation—let alone a fact—that Blackfeet has done or attempted to do business in the state of Illinois. Such an element would have to be a salient feature of Schacht's case since we do not understand the state of Illinois to presume to regulate the insurance industry outside its borders. The court, however, need not assume the existence of any facts to support a party's position in a summary judgment proceeding. See *Schulz* v. *Serfilco, Ltd.*, 965 F.2d 516, 519 (7th Cir. 1992).

A. Statutory Framework

The parties' dispute stems from the tension between federal banking law, as embodied in the Bank Act, and Illinois' regulation of the insurance industry. Under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011 et seq., state laws enacted "for the purpose of regulating the business of insurance" are exempted from traditional federal preemption principles. 15 U.S.C. § 1012(b).[2] The statute was enacted in 1945 in response to the Supreme Court's decision in *United States* v. *South-Eastern Underwriters Assn.*, 322 U.S. 533, 88 L. Ed. 1440, 64 S. Ct. 1162 (1944), in which the Court first held that the business of insurance was interstate commerce subject to the coverage of the Sherman Act.[3] Congress's primary concern in enacting the legislation was to ensure states would continue to have the ability to tax and regulate the business of

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[2] The statute provides, in relevant part:

> Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent such business is not regulated by state law.

[3] Prior to the *South-Eastern* holding, "[issuing] a policy of insurance [was] not a transaction of commerce." *Paul* v. *Virginia*, 75 U.S. 168, 8 Wall. 168, 183, 19 L. Ed. 357 (1869).

insurance without fear of Commerce Clause attack. *Group Life & Health Ins.* v. *Royal Drug Co.*, 440 U.S. 205, 217-218, 99 S. Ct. 1067, 59 L. Ed. 2d 261 (1979). The McCarran-Ferguson Act "overturn[ed] the normal legal rules of preemption" by imposing a rule "that state laws enacted for the purpose of regulating the business of insurance do not yield to conflicting federal, statutes unless a federal statue specifically requires otherwise." *U.S. Dept. of Treasury* v. *Fabe*, ___ U.S.___, 113 S. Ct. 2202, 2211, 124 L. Ed. 2d 449 (1993). The parties' discord, understandably, involves the issue of whether the Retirement CD falls within the business of insurance thereby subjecting it to state regulation.

As a national bank, Blackfeet is incorporated, organized, and chartered exclusively under the Bank Act. Its main office is located in the town of Browning, Montana, on the Blackfeet Indian Reservation. The plaintiffs argue that the Bank Act provides the sole authority under which they need operate. The Bank Act authorizes national banks such as Blackfeet to receive "deposits" as part of the exercise of "such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 (Seventh). The Office of the Comptroller of the Currency ("OCC"), the administrator of the Bank Act, has characterized the Retirement CD as a new form of "deposit." (See *infra* at 10). Essentially, the plaintiffs argue that the Bank Act preempts state regulation of national banks as Schacht attempts in this case, and that Schacht's efforts to regulate the Retirement CD are invalid under the Supremacy Clause.

The State of Illinois regulates the insurance industry under the Illinois Insurance Code, 215 ILCS 5/1 et seq. ("Insurance Code"). The Insurance Code includes "annuity contracts" in its definition of life insurance,

215 ILCS 5/4,[4] but offers no definition of annuity or annuity contract. The Illinois Department of Insurance has determined that the Retirement CD is within the definition of life insurance and annuities and, therefore, is subject to regulation under the Insurance Code. Pursuant to the Insurance Code, the Department of Insurance issued a "cease and desist" order to Blackfeet, charging that it was conducting insurance business without authority and without first procuring a certifi-

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[4] The statute defines life insurance broadly, as follows:

> (a) Life. Insurance on the lives of persons and every insurance appertaining thereto or connected therewith and granting, purchasing or disposing of annuities. Policies of life or endowment insurance or annuity contracts or contracts supplemental thereto which contain provisions for additional benefits in case of death by accidental means and provisions operating to safeguard such policies or contracts against lapse, to give a special surrender value, or special benefit, or an annuity, in the event, that the insured or annuitant shall become totally and permanently disabled as defined by the policy or contract, or which contain benefits providing acceleration of life or endowment or annuity benefits in advance of the time they would otherwise be payable, as an indemnity for long term care which is certified or ordered by a physician, including but not limited to, professional nursing care, medical care expenses, custodial nursing care, non-nursing custodial care provided in a nursing home or at a residence of the insured, or which contain benefits providing acceleration of life or endowment or annuity benefits in advance of the time they would otherwise be payable, at any time during the insured's lifetime, as an indemnity for a terminal illness shall be deemed to be policies of life or endowment insurance or annuity contracts within the intent of this clause.
>
> Also to be deemed as policies of life or endowment insurance or annuity contracts within the intent of this clause shall be those policies or riders that provide for the payment of up to 25% of the face amount of benefits in advance of the time they would otherwise be payable upon a diagnosis by a physician licensed to practice medicine in all of its branches that the insured has incurred one of the covered conditions listed in the policy or rider.

cate of authority in violation of 215 ILCS 5/121. Under that provision, it is "unlawful for any company [including an association, such as Blackfeet, under 215 ILCS 5/2(e)] ... to transact insurance business in this State, without a certificate of authority from the director ..." The Insurance Code provides for the issuance of a certificate of authority to domestic companies, 215 ILCS 5/24; 5/51, or foreign or alien companies. 215 ILCS 5/111. Domestic companies are those organized under the laws of the state of Illinois. 215 ILCS 5/2(f). A foreign company is one organized under the laws of any other state or territory of the United States, or the District of Columbia. 215 ILCS 5/2(g). An alien company is one organized under the laws of a country other than the United States. 215 ILCS 5/2(h). Organized under the Bank Act, Blackfeet does not qualify as a domestic, alien, or foreign company, which would lead one to believe that there are no circumstances under which it could receive a certificate of authority, even if it were to submit to the administrative hearing and agree to comply with the Insurance Code. There is another provision in the Insurance Code, however, that allows a national bank located in a town of 5000 or less—such as Blackfeet—to register with the director in order to transact insurance business as an insurance agency in Illinois. 215 ILCS 5/499.1(a); 215 ILCS 5/499.1(e).[5] Yet another provision that would appear to be an insurmountable hurdle for Blackfeet states that companies that engage in other business in addition to the life insurance business may not be certified to transact insurance business

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[5] This provision essentially echoes Section 92 of the Bank Act, which allows national banking associations located and doing business in towns with populations of no more than 5,000 "under such rules as may be prescribed by the Comptroller of the Currency, [to] act as agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said state, by soliciting and selling insurance and collecting premiums on policies issued by such company ..." 12 U.S.C. § 92.

under the Insurance Code. 215 ILCS 5/111(c). A bank such as Blackfeet obviously engages in many federally-authorized banking activities that would violate this provision.

The Insurance Code, then, includes a certain amount of seeming incongruities, when the facts of this case are considered, that the parties have had some difficulty resolving. Essentially, it would appear that a national bank could act as an agent for insurance products, but could not underwrite insurance risks as would an insurance company. In supplemental briefing in this matter, Schacht has submitted that the practical effect of these regulations is that the only way Blackfeet could sell and underwrite the Retirement CD—should the instrument qualify as insurance—is to set up a subsidiary for that purpose. Plaintiffs point out that such a requirement demonstrates that the Insurance Code discriminates against national banks such as Blackfeet. The applicability of this or any other requirement under the statutory framework, of course, is wholly dependent on the nature of the Retirement CD.

B. Terms of the Retirement CD

Blackfeet promotional materials (Plaintiff's Memorandum in Support of its Motion for Summary Judgment ("Pl.MSJ"), Ex. 3), describe the terms and conditions of the Retirement CD. The customer is required to open the Retirement CD with an minimum initial balance of $5000. At that time the Customer also selects a Maturity Date, which is often the customer's expected retirement. Interest, calculated under a formula tied to the then current five-year, U.S. Government Treasury Note yield, begins to accrue from the date of deposit. Under applicable IRS regulations, this interest is designed to be tax deferred. The initial rate is in effect for one year, and is subsequently adjusted every five years. Prior to the Maturity Date, withdrawals are subject to penalty

and IRS treatment as taxable income. On the Maturity Date, the customer may make a cash withdrawal in the amount of 2/3 of the account balance. Thereafter, the customer's lifetime Scheduled Monthly Withdrawal Payments will begin. The amount of the monthly payment is to be determined by the balance of the account after Maturity Date, the age of the customer, the monthly payment interest rate then in effect, and the Society of Actuaries annuity table. Once determined, the monthly payments to the customer will remained fixed over the customer's lifetime. For tax purposes, the payments will be apportioned from interest and principal. The FDIC, however, will only insure an amount equal to the customer's deposits and accrued interest; the total amount of lifetime monthly payments might exceed that amount but, once they do, they are not FDIC-insured.

C. Expert Characterizations of the Retirement CD

Each side to this dispute is armed with expert interpretations as to the nature of the Retirement CD. We begin our review of these with the OCC Interpretive Letter holding that the Retirement CD is within the powers of banks under the Bank Act under 12 U.S.C. § 24 (Seventh). (Pl.MSJ, Ex. 1). Essentially, the OCC felt that the offering of the Retirement CD was consistent with a bank's authority to receive deposits and to incur liabilities and to fund its operations. (*Id.* at 2-3). The OCC viewed the Retirement CD as a single financial product with a total return of the sum of (1) interest accrued until maturity, (2) the portion of the monthly, post-maturity payments allocable to interest, and (3) the amount of those monthly payments occurring after the return of the maturity balance. (*Id.* at 7). The OCC noted that, should the customer continue to live after the maturity balance was exhausted by monthly payments, the customer would nevertheless continue to receive monthly payments at the fixed rate. (*Id.*) The

OCC referred to these payment as "nothing more than additional interest." (*Id.*). One of the conditions the OCC set for the offering of the Retirement CD was that Blackfeet mitigate the "risk of paying interest throughout the life of each [customer] even in situations where the maturity balance becomes exhausted," with consideration given to purchasing commercially available annuities from insurance companies to fund this obligation. (*Id.* at 8). Blackfeet was to submit its plan regarding such mitigation to the OCC. (*Id.*).

While the OCC did not object to the offering of the Retirement CD, neither did it "approve" it. In a letter to the Chairman of the House Energy and Commerce Committee, Congressman John D. Dingell, the OCC indicated that the Retirement CD could be offered without OCC approval since it was within the powers of a national bank. (Memorandum of Law of ACLI, Ex. 8). The OCC stressed that its "no-objection" opinion was based solely on a determination of the bank's authority to conduct the business of banking. (*Id.* at 1-2). The OCC conceded that the Retirement CD possessed characteristics of an annuity, but did not comment on whether banks could underwrite annuities. (*Id.* at 2). In addition, the OCC allowed that state regulatory officials might conclude that insurance laws apply to the Retirement CD. (*Id.*). While the OCC did not address any state law requirements, it stated that the Blackfeet would be required to comply with all applicable state laws and regulations. (*Id.* at 4). The OCC would not comment on the preemptive effect of the Bank on state insurance law in the context of the Retirement CD.

The FDIC also offered its opinion as to the nature of the Retirement CD in order to determine whether it was a deposit entitled to FDIC insurance. (Pl.MSJ, Ex. 2). The FDIC determined that, in the event of a bank failure prior to maturity date, the Retirement CD would be insured to the extent of principal and accrued interest to

the date of the failure. (*Id.* at 3). If a failure occurred after maturity date, the FDIC would pay the customer the balance of the account at maturity date—principal plus accrued interest—minus the sum of any withdrawal and monthly payments already made. (*Id.* at 3-4). Under no circumstances, however, would the FDIC insure the bank's commitment to make lifetime, monthly payments because the value of such payments was uncertain and could exceed the total account balance. (*Id.* at 4). This portion of the Retirement CD, according to FDIC interpretation, did not fit into the definition of deposit under the FDI Act because the expected value of the contractually agreed-to monthly payments did not reflect an account balance based on deposited principal plus accrued interest. (*Id.* at 4).

Schacht has submitted the opinions of two experts in the Illinois Department of Insurance regarding the nature of the Retirement CD: that of Arnold Dutcher, the Deputy Director of the Regulatory Division; and that of Larry Gorski, the department's Life Actuary. (Defendant's Memorandum of Law in Support of Motion ("Def. Mem."), Exs. A; B). Mr. Dutcher felt that the Retirement CD was a fixed annuity life insurance contract similar to those products the state regulates as insurance. (*Id.*, Ex. A at ¶ 5). His opinion was based on the Retirement CD's promise of a monthly payment contingent on the customer's continued life, which gave the Retirement CD a mortality risk. (*Id.* at ¶ 7). The mortality risk means that the Retirement CD is not merely based on economic investment factors, according to Mr. Dutcher, but on the life at risk continuing beyond the expected term. (*Id.*, Ex. A at ¶ 8). Mr. Dutcher stated that dealing with this type of risk is the essence of the insurance underwriting industry. (*Id.*, Ex. A at ¶ 9). Mr. Dutcher also stated that the Insurance Code was designed to regulate underwriters and protect insureds in various specialized ways in view of these mortality risks. (*Id.*, Ex. A at ¶ 10).

Mr. Gorski basically agreed with Mr. Dutcher's assessment of the Retirement CD as an insurance product. (*Id.*, Ex. B). Because of the mortality risk inherent in such products, Mr. Gorski explained that state regulations such as the Insurance Code have built-in, conservative features with respect to the necessary reserve amounts for underwriting. (*Id.*, Ex. B at ¶¶ 12-13). These specialized regulations also touch on minimum capital and surplus amounts. (*Id.*, Ex. B at ¶ 15). Overall, then, the Insurance Code is designed to protect policyholders or annuitants given the specialized risks inherent in insurance or annuity products. (*Id.*, Ex. B at ¶¶ 18-19).

II. ANALYSIS

A. Abstention

Before returning to the Retirement CD itself, we must address Schacht's contentions that the federal court should abstain in this matter under two doctrines drawn from Supreme Court opinions: *Younger* v. *Harris*, 401 U.S. 37, 91 S. Ct. 746, 27 L. Ed. 2d 669 (1971); and *Burford* v. *Sun Oil Co.*, 319 U.S. 315, 63 S. Ct. 1098, 87 L. Ed. 1424 (1943). In addressing these contentions we note, first, that "only exceptional circumstances justify a federal court's refusal to decide a case in deference to the States." *New Orleans Public Service, Inc.* v. *Council of City of New Orleans* ("NOPSI"), 491 U.S. 350, 368, 105 L. Ed. 2d 298, 109 S. Ct. 2506 (1989). Second, and on the other hand, courts have long recognized a few well-defined classes of cases that fall outside the norm where abstention is not only permissible but expected. *Younger*, 401 U.S. at 43-44, 91 S. Ct. at 750.

1. *Younger* Abstention

In *Younger*, the Supreme Court held that absent extraordinary circumstances, federal courts must abstain from enjoining ongoing state criminal proceedings. *Id.* at

41, 91 S. Ct. at 750. At the core of any justification for abstention the Court noted, are the notions of comity and federalism:

> The concept does not mean blind deference to "States' Rights" any more than it means centralization of control over every important issue in our National Government and its courts. ... What the concept does represent is a system in which there is sensitivity to the legitimate interests of both State and National Government, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States.

Id. at 44, 91 S. Ct. at 750. Although *Younger* involved a suit to enjoin a state criminal proceeding, the doctrine has since been expanded beyond state criminal prosecutions to civil proceedings in state court implicating important state interests, *NOPSI*, 491 U.S. at 367-68, 109 S. Ct. at 2517-18 (citing *Huffman* v. *Pursue Ltd.*, 420 U.S. 592, 604, 95 S. Ct. 1200, 1208, 43 L. Ed. 2d 482 (1975); *Moore* v. *Sims*, 442 U.S. 415, 423, 99 S. Ct. 2371, 2377, 60 L. Ed. 2d 994 (1979)), and to certain state administrative proceedings that are judicial in nature. See *Middlesex County Ethics Comm.* v. *Garden State Bar Assoc.*, 457 U.S. 423, 102 S. Ct. 2515, 73 L. Ed. 2d 116 (1982) (lawyer disciplinary proceeding initiated by state ethics committee); *Ohio Civil Rights Comm'n* v. *Dayton Christian Sch., Inc.*, 477 U.S. 619, 106 S. Ct. 2718, 91 L. Ed. 2d 512 (1986) (barring injunction against an ongoing sex discrimination proceeding before state civil rights commission). Through these and other decisions, a three-part test has evolved for determining whether *Younger* abstention is appropriate in a given situation:

> (1) the judicial or judicial in nature state proceedings must be on-going;

(2) the proceedings must implicate important state interests; and

(3) there must be an adequate opportunity in the state court proceeding to raise constitutional challenges.

Middlesex County, 457 U.S. at 432, 102 S. Ct. at 2521; *Trust & Inv. Advisers, Inc.* v. *Hogsett*, 43 F.3d 290, 295 (7th Cir. 1994). We address each part of this test in turn.

Schacht submits that the proceeding at issue herein—the Department of Insurance's administrative hearing—is judicial in nature. It is governed by the Illinois Administrative Code, which provides that it shall be quasi-judicial, with the hearing officer conducting examination of witness, requiring production of evidence and ruling on admissibility. Witnesses are subject to cross-examination. The proceeding itself consists of the disposition of any preliminary motions, the presentation of the parties' opening statements, the presentation of the parties' cases-in-chief, opportunity for rebuttal, and closing statements. Plaintiffs do not really contest the nature of the proceedings, other than to argue that substance, rather than form, is the controlling factor in such a determination, citing *NOPSI*. (Plaintiff's Memorandum in Opposition ("Pl. Opp.") at 22). In *NOPSI*, however, the Court found that the ratemaking challenged therein, which established a rule for the future, was not judicial in nature but legislative. 491 U.S. at 371, 109 S. Ct. at 2520. Here, defendants cannot, and do not, seriously argue that the challenged proceeding is one in which there is the making of a new rule for the future and is therefore legislative. Clearly, the administrative proceeding is aimed at determining the applicability of the Insurance Code to the Retirement CD.

Next, Schacht contends that important state interests are involved. Clearly, the regulation of the insurance industry is an important state interest. See *supra* at 3-4.

Plaintiffs do not dispute this, but focus their attention on the remaining part of the test, the competency of the state forum to address their constitutional concerns.[6] A fundamental assumption underlying the *Younger* abstention doctrine is the availability of a competent state forum. *Withrow* v. *Larkin*, 421 U.S. 35, 44 n. 8, 95 S. Ct. 1456, 43 L. Ed. 2d 712 (1975); *Gibson* v. *Berryhill*, 411 U.S. 564, 577, 93 S. Ct. 1689, 36 L. Ed. 2d 488 (1973). When the state tribunal is deemed to be biased or to have otherwise prejudged the controversy, abstention in deference to the state proceeding under *Younger* is inappropriate. *Hogsett*, 43 F.3d 290, 295 (7th Cir. 1994). Here, Schacht, the Director of the Illinois Department of Insurance has already determined that the Retirement CD is an annuity and is therefore subject to regulation under the Insurance Code. He has in no way represented in these proceedings that he has not yet reached this conclusion, or that he will only reach it upon the conclusion of the challenged administrative proceedings. His position herein has not been merely that he is of a high degree of expertise in examining the Retirement CD and determining its character; he has, instead, steadfastly maintained that the Retirement CD is an annuity subject to insurance regulation. In this regard, we find that Schacht has prejudged the integral element of this case—such is clear from his submissions on this issue in this court. Accordingly, we find *Younger* abstention inappropriate in this matter.

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[6] At times, the absence of a competent state tribunal is considered under the third part of the test. *Hogsett*, 43 F.3d at 295 n.6. It has also been described as one of the "extraordinary circumstances alluded to in *Younger* where abstention is inappropriate even though all of the *Younger* elements have been met." *Id.*, quoting *Kugler* v. *Helfant*, 421 U.S. 117, 124-25 n.4, 95 S. Ct. 1524, 1530-31 n.4, 44 L. Ed. 2d 15 (1975). We consider it within the third part of the test here.

2. *Burford* Abstention

Schacht next argues that *Burford* abstention requires dismissal of this action. Burford abstention is concerned with the protection of complex state administrative processes from undue federal interference. *NOPSI*, 491 U.S. at 362, 109 S. Ct. at 2515. It does not, however, require abstention whenever such a process exists, or whenever there is a potential for conflict. *Id.* The heart of the dispute herein is not whether the state is misapplying its lawful authority or has failed to adequately consider relevant state-law factors—abstention might be appropriate under such circumstances. *Id.* Instead, the issue here is whether the nature of the Retirement CD even brings it under the auspices of state law or regulatory authority. As noted above, the state has already assumed that it does. We, however, are not prepared to take that leap of faith before examining the Retirement CD. Once again, given the posture of this case, abstention would be inappropriate.

B. The Nature of the Retirement CD

The power to name a thing has often been associated, in theology and philosophy, with the power to exercise dominion over that thing. In the Book of Genesis, whatever Adam chose to name the creatures God paraded before him, that was what they were. GENESIS 2:19. The power to name is, at times, assumed to denote a superior understanding of the nature of the thing named, perhaps because the ability to name can be a prerequisite to that understanding. In this case, the parties toss about various names to denote their understanding of the Retirement CD: deposit, investment, annuity, insurance. In so doing, each side is able to bring the Retirement CD within its auspices. As the plaintiffs would have it, if the OCC determines that the Retirement CD is a deposit—and it did—then it is a deposit and is a power of banking that cannot be subject

to state regulation. If it is an annuity—and both sides appear to concede that it is—then, according to Schacht, it is subject to state regulation because the Insurance Code says that the Insurance Code applies to annuities. Simple enough, until one questions the nature of a deposit, the nature of an annuity, the nature of the Retirement CD itself. Then, the parties' positions bring to mind a passage from Lewis Carroll:

> "When I use a word," Humpty Dumpty said in a rather scornful tone, "it means just what I choose it to mean, neither more nor less."
>
> "The question is," said Alice, "whether you can make words mean so many different things."
>
> "The question is," said Humpty Dumpty, "which is to be the master—that's all."

LEWIS CARROLL, THROUGH THE LOOKING-GLASS, ch. 6 (1872). Here, rather than choose a word to mean "Retirement CD," we look to nature of the product to determine whether or not that nature makes it an appropriate subject for regulation under the Insurance Code.

1. Retirement CD as Deposit

We begin with an analysis of the plaintiffs' position: that the Retirement CD is merely a "deposit" which removes it from the regulatory realm of the state of Illinois. The plaintiffs assert that their position is based on the definition of a "deposit" in the ordinary sense of the term, and the definitions applied by the two pertinent federal regulatory authorities: the OCC and the FDIC. From an ordinary sense standpoint, plaintiffs cite BLACK'S LAW DICTIONARY for the proposition that a "deposit" refers to any money " 'placed in the custody of a bank or banker, for safety or convenience, to be withdrawn at the will of the depositor or under such rules and regulations agreed upon.' " (Pl.Mem. at 5;

Plaintiffs' Reply Memorandum ("Pl.Reply") at 2; quoting BLACK'S LAW DICTIONARY 438 (6th ed. 1990)). Plaintiffs go on to explain that:

> [a] bank deposit thus encompasses any transaction where a customer (1) places his money in a bank's hands under (2) an agreement establishing terms for its return. An agreement as to when and how a depositor's money will be withdrawn, then, is an integral feature of every bank deposit agreement. Any number of withdrawal agreements between the depositor are feasible (subject, of course, to comprehensive federal regulation). The agreement may provide for the bank to return the money or some portion thereof to the customer upon demand, as in a traditional checking account; or with payment of interest at a fixed or variable rate on the outstanding balance, as in a NOW account. The agreement may provide for interest to be paid at a fixed rate on the balance with repayment only upon a stated advance notice, as in a traditional savings account; or the agreement may provide for repayment with interest at a fixed date in the future, or with a penalty for early withdrawal, as in a conventional certificate of deposit; or the agreement may provide for interest to be paid at a rate tied to a financial indicator such as stock market performance. That all these different withdrawal mechanisms nonetheless qualify as "deposits" is black-letter law.

(Pl.Reply at 2-3 (citations omitted)). Based on these factors—the placement of money with a bank and an agreement establishing terms for the return of the money—plaintiffs argue that the Retirement CD fits easily within the category of "deposits." The problem is, so would a single premium, whole life insurance policy sold by a bank: a placement of funds and a return of those funds upon an event that is agreed upon. We do not suspect, however, that the plaintiffs would argue

that single premium, whole life insurance could not be regulated by the states.

None of the agreements establishing terms for return of deposited money cited by plaintiffs involve a return of money over and above principal and accumulated interest; yet, this is the key element of the Retirement CD. The guarantee of a fixed monthly lifetime payment is the selling point of the product, the feature emphasized in promotional materials. (Pl.MSJ, Ex. 3). The monthly payment can continue long after the exhaustion of principal and interest. It is this feature that makes the Retirement CD an unwieldy fit into the "deposit" category.

Plaintiffs rely to a great extent on the OCC's "no-objection" letter in which the OCC found the Retirement CD fell within traditional banking powers of receiving deposits, and incurring liabilities and funding its operations. Citing *NationsBank of N.C.* v. *Variable Annuity Life Ins.*, ___ U.S. ___, 115 S. Ct. 810, 130 L. Ed. 2d 740 (1995), plaintiffs argue that the OCC's determination that the Retirement CD is a deposit is entitled to controlling weight. (Pl.Reply at 5). In *NationsBank*, the OCC approved a national bank's application to broker annuities as an incidental power necessary to carry on the business of banking. ___ U.S. at ___, 115 S. Ct. at 815. The Court stated that the judgment of an administrator—such as the OCC—that defines a term in a way that is reasonable in light of the legislature's revealed design is entitled to controlling weight. *Id.* at ___, 115 S. Ct. at 813-14. After examining the OCC's conclusions in light of the Bank Act, the Court found the OCC's approval to be reasonable. *Id.* at ___, 115 S. Ct. at 815. For three reasons, however, we are not persuaded by the plaintiff's citation to *NationsBank*.

First, it is important to distinguish the activity at issue in *NationsBank* with that at issue here. In *NationsBank*, the Court and the OCC were concerned with a

bank's authority to act as a broker for annuities issued by insurance companies, to offer an additional service to its customers. *Id.* at ___, 115 S. Ct. at 812. While banks can act as broker for securities, as an example, they cannot underwrite the issue of securities or stock. 12 U.S.C. § 24 (Seventh) cited in *NationsBank*, ___ U.S. at ___, 115 S. Ct. at 813. Banks in towns of 5,000 or less in population can also broker, as oppose to underwrite, insurance. 12 U.S.C. § 92. Here, conversely, we are not concerned with a bank's authority to act as a broker for the Retirement CD, we are concerned with the risks attendant to underwriting such a product. Schacht's threatened action against Blackfeet was prompted by his perception that those risks should be subject to state regulation; that is what this case is about. The question of state regulation of insurance did not arise in *NationsBank*; presumably, the insurance companies that actually issued and underwrote the annuities in that case had already been subjected to the type of regulatory framework Schacht seeks to impose here.

Second, the OCC in *NationsBank* issued an approval letter in response to the bank's application for same. *Variable Annuity Life Ins. Co.* v. *Clarke*, 998 F.2d 1295, 1297 (5th Cir. 1993); *Variable Annuity Life Ins. Co.* v. *Clarke*, 786 F. Supp. 639, 640-41 (S.D.Tex. 1991). Here, by comparison, Blackfeet did not seek approval or permission from the OCC to issue the Retirement CD, and the OCC issued "no-objection" letter as opposed to a formal approval. (Memorandum of Law of ACLI, Ex. 8 at 1-2). While the parties do not address this distinction, the OCC's own language, we feel, reduces the weight we need accord the "no-objection" letter herein. The OCC's primary concern regarding the Retirement CD was that the bank mitigate the risk of lifetime payments even in situations where the maturity balance is exhausted, and suggested the bank purchase annuities from insurance companies to fund such an obligation. In its letter to Congressman Dingell, the OCC reserved judgment on

whether a bank could underwrite annuities and whether the Bank Act preempted state insurance law, but conceded that state officials might deem the Retirement CD subject to insurance regulation and that Blackfeet would have to comply with all applicable state laws. (*Id.* at 2-4). As we intimated at the outset of this discussion, this case is not so much concerned with the proper anointment of the Retirement CD as deposit or insurance, but with the nature of the product itself. The OCC does not really address these concerns but, indeed, appears to suggest that, deposit or not, the Retirement CD might be within the regulatory ambit of state insurance laws. Accordingly, we do not feel constrained to hold that the product is a deposit and therefore beyond the reach of the Insurance Code on the basis of the OCC's "no-objection" letter.

Third, and finally, even if we were to apply *NationsBank* to the OCC "no-objection" position that the Retirement CD is a "deposit" and determine the deference to be accorded that position, we would have to stop short of giving it controlling weight. We return to the salient feature of the product: the guaranteed, lifetime monthly payment. Noting that there was the possibility that such payments would go on beyond the exhaustion of the maturity balance, the OCC characterized them as "additional interest." We are troubled by this rationale. Interest is ordinarily earned while there is a principal at work—the two go hand and hand—and is definable at a certain rate. BLACK'S LAW DICTIONARY, 812-13 (6th ed. 1990). Neither can be said of the lifetime monthly payments that are the salient feature of the Retirement CD. While we do not reach a *NationsBank* examination of the OCC's "no-objection" letter, we would be extremely reluctant to accept the attribution of the lifetime, monthly payments after the exhaustion of principal and interest as "additional interest." This integral part of the Retirement CD was also cause for concern to the FDIC, upon whose opinion plaintiffs also rely.

The FDIC's opinion regarding the insurability of the Retirement CD lends more comfort to Schacht than to the plaintiffs. Based on the FDI Act's definition of a "deposit," the FDIC limited the insurable amount of the Retirement CD to the principal and interest. "Under no circumstances" would the FDIC insure the banks commitment to make lifetime monthly payments. (Pl.MSJ, Ex. 2 at 4). According to the FDIC, such an arrangement was not contemplated by the FDI Act's definition of "deposit." In an effort to reduce the significance of this limitation on FDIC insurance, plaintiffs can only point out that "FDIC insurance on all bank deposits is limited to $100,000 dollars, but a deposit of $101,000 or $1,000,000 remains a deposit" under federal banking law ..." (Pl.Reply at 6). This argument, however, confuses a limitation on the *amount* the FDIC will insure with the nature of things it will insure. Suppose a Retirement CD customer has a maturity balance at age 65 of $14,400. He withdraws 2/3—$9,600—leaving a balance of $4,800. Ignoring for the moment the applicable interest rate, and assuming his life expectancy was another ten years—120 months—the bank would, under the terms of the Retirement CD, guarantee him a lifetime monthly payment of $40. Despite the fact that the customer would have to another 188 years before the total return would reach the FDIC's $100,000 insurance limit, there would be no FDIC insurance on any payments beyond the $4,800. There is simply no basis whatsoever to analogize the FDIC's refusal to insure lifetime monthly payments over and above principal and interest with its insurance limit of $100,000 on deposits. The FDIC's refusal to extend insurance to the salient feature of the Retirement CD is not based on an amount of deposit, but on the nature of the product. It is the nature of the product, not whether it can be called a "deposit" in certain contexts, that is at issue here.

2. Retirement CD as Insurance Product

We turn now to consider Schacht's position: that the Retirement CD is an annuity and, therefore, is subject to regulation under the Insurance Code. Schacht's argument, to an extent, is similar to that of the plaintiffs: because the Retirement CD is an annuity and the Insurance Code lists annuities as subject to insurance regulation, the Retirement CD should be subject to insurance regulation. Granted, it would appear that all fifty states regulate annuities under their insurance laws. See *Variable Annuity Life Ins. Co.* v. *Clarke*, 998 F.2d 1295, 1300 n.2 (5th Cir. 1993) *rev'd on other grounds*, *NationsBank* (collected state statutes). The association of the term "annuity" with a state's insurance laws is no more dispositive of the issue before us, however, than the reference to the Retirement CD as a deposit already discussed. Instead, it is the nature of the Retirement CD that is at issue here, especially the risks inherent in the product. Whether the Retirement CD is called a "deposit," an "annuity," or an "insurance product," the risk involved, correctly identified by Schacht, is a "mortality risk." It is this element of "mortality risk" that, in large part, we believe, renders the Retirement CD an appropriate subject for state insurance regulation.

The fundamental characteristic of insurance is the spreading and underwriting of risk; the risk to be insured against is shifted or distributed. *Group Life & Health Ins.* v. *Royal Drug Co.*, 440 U.S. 205, 211, 99 S. Ct. 1067, 1073, 59 L. Ed. 2d 261 (1979); *Barnes* v. *United States*, 801 F.2d 984, 985 (7th Cir. 1986). In the life insurance context, the Seventh Circuit has explained that:

> the insured and the insurer are both betting on the longevity of the insured. The risk to the insurer is that death will come before the value for premiums paid exceeds the death benefit. The insured risks that the value of his or her payments will surpass the promised payment before death. If the contract

> operates to insure a risk-free system for either party, it is not a life insurance contract.

Barnes, 801 F.2d at 985 (citations omitted). Thus, a longevity or "mortality risk" is a necessary, although perhaps not a sufficient, element of insurance. Insurance also requires, in combination with the mortality risk, a guarantee of a fixed return. *Securities & Exch. Com'n* v. *Variable Ann. Ins. Co.*, 359 U.S. 65, 71, 79 S. Ct. 618, 622, 3 L. Ed. 2d 640 (1959), cited in *Royal Drug*, 440 U.S. at 212, 99 S. Ct. at 1073-74; *Otto* v. *Variable Annuity Life Ins.*, 814 F.2d 1127, 1131 (7th Cir. 1986). In *Securities & Exch.*, the Court considered a mortality risk without the element of a fixed return to be a "superficial" mortality risk. 359 U.S. at 71, 79 S. Ct. at 622. While it is not clear whether mortality risk and guaranteed fixed return are separate elements of insurance, or whether a guaranteed fixed return is essential to a "true" mortality risk, the insurance encompasses both features in some fashion.

An annuity can perhaps best be described as the mirror image of life insurance. *Clarke*, 998 F.2d at 1301. The annuitant and the issuer of the annuity are, again, both betting on the longevity of the annuitant. In the case of an annuity, however, the annuitant risks that death will come before he or she receives annuity payments in the amount he or expended to purchase the annuity. The issuer risks that the annuitant will live so long that the annuity payments will exceed the value of the price received for the annuity. See, generally, *Id.*; and *Associates in Adolescent Psychiatry* v. *Home Life*, 941 F.2d 561, 565 (7th Cir. 1991). Just as in the case of the insurance policy, the fundamental risk of an annuity is a mortality risk.

Like the life insurance context, the presence of a mortality risk is not alone sufficient to render an annuity "insurance" or an "insurance product." An annuity contract that does not guarantee a fixed return does not

place a true mortality risk on the issuer, a true insurance underwriting risk. *Securities & Exch.*, 359 U.S. at 71-73, 79 S. Ct. at 622-23; *Otto*, 814 F.2d at 1131. Plaintiffs take this idea a step too far, however, citing *NationsBank* for the proposition that a mortality risk has little or no influence on the nature of a product. (Pl.MSJ at 20; Pl.Opp. at 8). In *NationsBank*, the Court's holding was simply that the OCC could reasonably find the selling, as opposed to the underwriting, of annuities was an incidental power of banking. *Id.* at ___, 115 S. Ct. at 815. While the Court also accepted as reasonable the OCC's point that a mortality risk was not a necessary feature of many modern annuities, this point was based on the fact that many such products do not feature a life term—as opposed to the Retirement CD. ___ U.S. at ___, 115 S. Ct. at 816. In addition, as we already noted, the *NationsBank* Court was dealing with a national bank brokering, as opposed to underwriting, annuities. Even in the context of a fixed annuity with a life term, then, as between purchaser and bank, only the purchaser would be assuming a mortality risk. *Id.* at ___, 115 S. Ct. at 816. *NationsBank* did not address the notion of a guaranteed, fixed return that, as we have seen, must be coupled with a mortality risk to render an annuity an insurance product. Thus, as we have already intimated earlier in our discussion, the *NationsBank* holding does not address the concerns we have with the case before us. In any event, it is not inconsistent with the notion that an annuity can be called an insurance product when it involves not only a mortality risk to annuitant and issuer, but includes a guaranteed fixed return. *Securities & Exch. Com'n*, 359 U.S. at 71-73, 79 S. Ct. at 622; *Otto*, 814 F.2d at 1131. When the terms of the Retirement CD are examined, it becomes clear that by its nature it is the type of annuity that qualifies as an insurance product in this context.

The Retirement CD customer places a lump sum with Blackfeet in exchange for a lifetime monthly payment.

Whether that sum is called a "deposit" or the purchase price of the annuity does not affect the nature of the product. Clearly, there is a traditional, insurance-product mortality risk to both the customer and Blackfeet. The customer hopes to lives long enough that the monthly lifetime payments exceed the value of the lump sum or, more specifically, the maturity balance. Blackfeet calculates the amount of the monthly payments based, in substantial part, on the actuarial prediction of how long the customer will live; it wagers that the customer will not live so long as to exhaust the maturity balance. This gamble is a true insurance risk under *Securities & Exch.*: the lifetime monthly payments are guaranteed. Thus, there is a mortality risk to both parties and a guaranteed return. Whether it is called a "deposit," an "annuity," or something else, the nature of the Retirement CD makes it an appropriate subject for regulation as an insurance product because it entails an insurance or mortality risk and a guaranteed return.

Plaintiffs disagree with the characterization of the risk to Blackfeet and its customers as an insurance risk. While they do not retreat from their position that the Retirement CD is a "deposit," they submit that, to the extent it can be considered an annuity, it involves an "investment risk" as opposed to an insurance risk. (Pl.MSJ at 20; Pl.Opp. at 6-8). In fact, plaintiffs contend that annuities and insurance are opposites, citing *Helvering* v. *Le Gierse*, 312 U.S. 531, 61 S. Ct. 646, 85 L. Ed. 996 (1941) and *Keller* v. *Commissioner of Internal Revenue*, 312 U.S. 543, 61 S. Ct. 651, 85 L. Ed. 1032 (1941). These companion cases dealt with the tax consequences of two similar, single transactions that combined an annuity and a life insurance policy. *Helvering*, 312 U.S. at 536-37, 61 S. Ct. at 648; *Keller*, 312 U.S. at 543-44, 61 S. Ct. at 652. Neither holding undermines the conclusion that the Retirement CD, by any other name, involves a mortality risk that is a proper focus of state

insurance regulation. In *Helvering*, the Court stated that:

> annuity and insurance are opposites; in combination the one neutralizes the risk customarily inherent in the other. From the [issuing] company's viewpoint, insurance looks to longevity, annuity to transiency.

312 U.S. at 541, 61 S. Ct. at 650.[7] Either risk—longevity or transiency—is a mortality risk. The annuitant gambles that he or she will live long enough that annuity payments will exceed the price of the annuity; the company issuing the annuity takes the opposite position. In the context of a life insurance policy, the positions are reversed, with the issuing company hoping the policyholder will live long enough that the earnings on the premiums he or she pays will eclipse the amount of the agree upon death benefit. The element of risk, in either case, is the same. Thus, in both *Helvering* and *Keller*, the Court found that the issuance of annuity and insurance policy in combination "countervailed a risk otherwise assumed in [the issuance of an] "insurance" policy." *Keller*, 312 U.S. at 545, 61 S. Ct. at 652. Neither case undermines the conclusion that the Retirement CD is an appropriate subject for regulation as an insurance product.

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[7] Plaintiffs mistakenly cite *Helvering* for the proposition that an "annuity involves 'investment risk similar to the risk assumed by a bank ... not an insurance risk.' " (Pl.MSJ at 20). In fact the court held that, for tax purposes, the risk assumed by the company issuing the combination annuity-life insurance policy was similar to a mere investment risk, as opposed to an insurance risk. *Helvering*, 312 U.S. at 542, 61 S. Ct. at 650. The issuance of the two items—annuity and insurance policy—in a single transaction neutralized the "mortality risks" that ordinarily accompany the issuing of either item separately. *Id.* at 541, 61 S. Ct. at 650.

C. The Bank Act and the Insurance Code

Having determined the Retirement CD meets the definition of an insurance product that is an appropriate subject for regulation, we need only briefly consider two additional points: federal preemption and the McCarran-Ferguson Act. The plaintiffs argue that the Bank Act preempts the Insurance Code insofar as the state regulation of a national bank is inconsistent with, or conflicts with, federal law. According to Schacht, however, there is no real conflict between state and federal law here. To the extent that there may be, Schacht contends that state regulation of the Retirement CD is saved from preemption by the McCarran-Ferguson Act.

1. Preemption

The Supremacy Clause of Article VI of the Constitution provides Congress with the power to preempt state law. Preemption occurs when Congress, in enacting a federal statute, expresses a clear intent to preempt state law; when there is outright or actual conflict between federal and state law; where compliance with both federal and state law is in effect physically impossible; where there is implicit in federal law a barrier to state regulation; where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law; or where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress. *Louisiana Public Service Com'n* v. *F.C.C.*, 476 U.S. 355, 360-61, 106 S. Ct. 1890, 1898, 90 L. Ed. 2d 369 (1986). Preemption may result not only from action taken by Congress itself; a federal agency acting within the scope of its congressionally delegated authority may preempt state regulation. *Id.* at 369, 106 S. Ct. at 1898-99. Here, the plaintiffs submit that the Bank Act—specifically 12 U.S.C. § 24 (Seventh)—preempts the Insurance Code, essentially by authorizing banks to receive deposits. We cannot agree with the plaintiffs' line of reasoning.

The portion of the Bank Act authorizing national banks to receive deposits has nothing to do with a bank's power to underwrite annuities or insurance risks. Quite simply, there is no conflict between the Bank Act and the Insurance Code's regulation of insurance products in this context; the issue of the Bank Act's preemption of the Insurance Code in this case is illusionary. The only real conflict in this case is between the Insurance Code and the OCC's "no-objection" letter finding the Retirement CD could be considered a "deposit" under the Bank Act. As we stated above, a federal agency acting within its delegated authority can preempt state regulation, but that is not what the OCC did here. In order to preempt state authority, the OCC must establish rules with the force of law, such as a regulation adopted after notice and comment rulemaking. *Wabash Valley Power* v. *Rural Electrification Admin.*, 903 F.2d 445, 453-54 (7th Cir. 1990) (citing *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 153, 102 S. Ct. 3014, 3022, 73 L. Ed. 2d 664 (1982)). The OCC's "no-objection" letter to Blackfeet simply cannot be accorded preemptive effect.[8] *Wabash Valley*, 903 F.2d at 453-54. Thus, the Bank Act, or more accurately for the purposes of this case, the OCC's "no-objection" letter does not preempt the state of Illinois' regulatory authority over the Retirement CD.

2. McCarran-Ferguson Act

Even if § 24 of the Bank Act or the "no-objection" letter could be considered to preempt the Insurance

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[8] This is not an instance where we have occasion to consider an OCC ruling as to the preemptive effect of the Bank Act. See, *e.g. Idaho Dept. of Finance* v. *Security Pacific Bank*, 800 F. Supp. 922 (D.Idaho 1992). In fact, the OCC's position on preemption in this matter has been at best elusive: the OCC has conceded that state regulatory officials could conclude that insurance laws applied to the Retirement CD and that Blackfeet would be required to comply with all applicable state laws and regulations. *Supra* at 10-11.

Code in terms of regulation of the Retirement CD, the Insurance Code would be "immunized" by the McCarran-Ferguson Act. The relevant portion of the McCarran-Ferguson Act provides:

> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance ...

15 U.S.C. § 1012(b). Thus, the Insurance Code is not preempted by § 24 if the Insurance Code was "enacted...for the purpose of regulating the business of insurance" and § 24 does not "specifically relate[] to the business of insurance."

We first consider whether the Insurance Code and, specifically, those licensing and certification regulations at issue here, were enacted for the purpose of regulating the business of insurance. In *Union Labor Life Insurance Co.* v. *Pireno*, 458 U.S. 119, 102 S. Ct. 3002, 73 L. Ed. 2d 647 (1982), the Supreme Court defined the business of insurance as being made up of practices and activities that satisfy the following criteria:

> *first*, whether the practice has the effect of spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry.

458 U.S. at 129, 102 S. Ct. at 3009. The issue here, then, is whether the Insurance Code was enacted with the "end, intention, or aim" to regulate these types of practices and activities. *U.S. Dept. of Treasury* v. *Fabe*, ___ U.S. ___, 113 S. Ct. 2202, 2210, 124 L. Ed. 2d 449 (1993). Clearly, the Insurance Code and its licensing and certif-

cation provision were enacted with just such an "end, intention, or aim."[9]

The Insurance Code is a comprehensive regulatory scheme that provides for analysis of financial statements of licensed companies, periodic financial and market conduct examinations of insurance companies, examination and licensing of insurance producers, review and approval of policy forms, regulation and adjustment of rates, and investigation of consumer complaints. (Def.Mem., Ex. A at ¶ 10; Defendant's Memorandum In Opposition, Ex. A). The licensing and certification provisions at issue herein are necessary to allow the Department of Insurance to enforce the Insurance Code. The Department cannot regulate the activities of unlicensed entities except to put a halt to those activities. (Def.Mem., Ex. A at ¶ 11). These regulations are designed to protect the consumer in risk-spreading situations and govern the relationship between the consumer as policyholder and the issuing company, and apply to entities conducting business in the insurance industry. In short, the focus of the Insurance Code and its licensing provisions is the protection of insurance consumers, the regulation and enforcement of the relationship between consumers and insurance companies, and the oversight of that relationship's reliability: these, too, are the focus of the McCarran-Ferguson Act. *Fabe*, ___ U.S. at ___, 113 S. Ct. at 2208 (citing *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 460, 89 S. Ct. 564, 568, 21 L. Ed. 2d 668 (1969)).

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[9] Rather than focus on the Insurance Code, the parties direct their McCarran-Ferguson analysis to the nature of the Retirement CD in the effort, we assume, to determine whether the specific regulation of this specific product fits within the McCarran-Ferguson preemption immunization. While we find that the statute as is should be the focus of a McCarran-Ferguson analysis, it is clear from our earlier discussion that the nature of the Retirement CD makes it an appropriate subject for insurance regulation.

It remains to be seen whether the Bank Act— especially § 24—specifically relates to the business of insurance. This section, which enumerates banking powers, makes no mention of insurance or the insurance industry. It does not touch on risk-spreading or the relationship between policyholder and insurance company, nor is it aimed at practices that are exclusively within the insurance industry. It is rather obvious that it does not specifically relate to the business of insurance. Plaintiffs do not seriously contend otherwise but do submit that, to the extent the Retirement CD can be considered an insurance product, the Bank Act's authorization of the Retirement CD specifically relates to the business of insurance. (Pl.MSJ at 23).

The Bank Act does not "specifically" authorize the Retirement CD, of course; the OCC interprets it to do so in a "no-objection" letter. As we noted in the previous discussion, this cannot be accorded preemptive effect. See *supra* at 31-32. Furthermore, in the McCarran-Ferguson context, neither the Bank Act nor the OCC's "no-objection" letter "specifically require[]" the Insurance Code to yield to the Bank Act. See *Fabe*, ___ U.S. at ___, 113 S. Ct. at 2211. As we discussed earlier, the OCC's position is, in fact, to the contrary. *Supra* at 10-11, 32 n.8. Thus, we can interpret neither the Bank Act nor § 24 to "specifically relate to the business of insurance" under the McCarran-Ferguson Act.[10] Thus, even if the Bank Act or the OCC "no-objection" letter could be considered to preempt the Insurance Code, the Insur-

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[10] Indeed, the fact that § 24, enacted as part of the original Bank Act in 1864, was in existence at the time the McCarran-Ferguson Act became law is strong evidence that § 24 cannot be construed as relating to the business of insurance. The McCarran-Ferguson Act's co-sponsor, Senator Ferguson, explained the intent behind 15 U.S.C. § 1012(b) as follows:

> What we have in mind is that the insurance business, being interstate commerce, if we merely enact a law relating in some

ance Code would be immunized from preemption by the McCarran-Ferguson Act.

III. CONCLUSION

The Retirement CD is, as plaintiffs taut, an "innovative" product, a "new and unique" concept, the only one of its kind—at least as far as banking is concerned. Its innovations fit rather easily into the concept of insurance. Be that as it may, because of its special features, it entails special risks; risks that make it an appropriate subject for insurance regulation. For our purposes, the names that the parties can apply to the Retirement CD are not of as much consequence as the appropriate protection of potential customers. As Berowne lectured in *Love's Labor's Lost*:

> These earthly godfathers of heaven's lights
> That give a name to every fixed star,
> Have no more profit of their shining nights
> Than those that walk and wot not what they are.

WILLIAM SHAKESPEARE, LOVE'S LABOR'S LOST, act I, sc. i, l. 84. Better to anger earthly godfathers herein and assure the appropriate regulations will protect those who have no special ken in the matters of "deposits," or "annuities" or "insurance." Accordingly, we must find that the Retirement CD is an appropriate subject for regulation under the Illinois Insurance Code and that the National Bank Act does not direct otherwise.

> way to interstate commerce, it would not apply to insurance. We wanted to make sure that the Congress, in its wisdom, would act specifically with reference to insurance in enacting the law.

Later in the same discussion, it was confirmed that:

> no existing law and no future law should, by mere implication, be applied to the business of insurance.

91 CONG.REC. 1487 (1945), cited in *Fabe*, ___ U.S. at ___ n.7, 113 S. Ct. at 2211 n.7 (emphasis added).

For the foregoing reasons, it is hereby ordered that the defendant's motion for summary judgment is GRANTED, that the plaintiffs' motion for summary judgment is DENIED, and that the plaintiffs' cause of action is dismissed.

ENTER:

EDWARD A. BOBRICK

U.S. Magistrate Judge

DATE: May 24, 1995

APPENDIX C

DETERMINATION OF THE OCC

Comptroller of the Currency
Administrator of National Banks
Washington, D.C. 20219

May 12, 1994

Blackfeet National Bank
P.O. Box 730
Browning, Montana 59417-0730

Dear Mr. Kelly:

In its November 8, 1993, letter to the Comptroller of the Currency ("OCC") Blackfeet National Bank (the "Bank") advised of its intention to market a new Retirement CD. The Bank has furnished the OCC with information concerning the product. The information includes a description of the product dated May 5, 1994, several legal opinions from outside law firms that address Federal deposit insurance and tax issues related to the product,[1] draft promotional materials dated February 26, 1994, and a license agreement between the Bank and American Deposit Corp., dated January 14, 1994. (Collectively this information is referred to herein as the "Information.")

This is to inform you that based on the Information, the OCC has no objection if the Bank proceeds with its plans to market and offer the Retirement CD provided that the program is operated in a safe and sound manner in accordance with the conditions sets forth below. We express no opinion on the deposit insurance status of the Retirement CD under the Federal Deposit Insurance Act, nor on the tax treatment of the Retirement CD under the

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[1] The legal opinions furnished are dated May 2, 1989; January 28, 1991; November 24, 1993; and December 17, 1993.

Internal Revenue Code. Should it choose to offer the Retirement CD, the OCC expects the Bank accurately to represent the risks and economics of the product, the deposit insurance status and the tax treatment of the Retirement CD in its dealings with actual and prospective customers. A change in the product's structure or terms, or the emergency of safety and soundness concerns associated with either the product or the manner in which the Bank is administering the product, may result in a revocation of our no objection position. In that event, the OCC reserves the right to take any appropriate actions.

I. Summary

The Bank has represented the basic terms of the Retirement CD to be as follows. It will be offered to individuals who will open an account by making a deposit with the Bank. At the time of the initial deposit, the customer will choose a maturity date for the account. During the period before the maturity date, interest will be credited to the account. Each customer will be entitled to select a term of from one to five years during which the interest rate will remain fixed, and after which the rate will fluctuate at the Bank's discretion, in accordance with its cost of funds. Additional deposits can be made up until the maturity date.

On the maturity date the customer will select from various options for repayment. These options will permit the customer to withdraw up to two-thirds of the balance in the customer's account (principal plus accrued interest) on the maturity date. The balance of the account will be distributed to the customer in fixed periodic amounts which will include interest, for the customer's life. The period amounts will be determined with reference to permanent purchase rate guarantees (*e.g.*, an assumed minimum interest rate of 3 percent at

competitive interest rates, and will include a simple refund feature. Under the refund feature, the customer (or his estate or beneficiary) will be guaranteed to receive an amount at least equalling the customer's account balance on the maturity date.

The Bank has represented that it will pay deposit insurance assessments to the Federal Deposit Insurance Corporation (the "FDIC"), as required by 12 U.S.C. 1817, on the total customer account contributions, plus interest which, until maturity, accrues on the account. In addition, the Bank has stated that the funds received will be subject to Federal Reserve Board Regulation D, 12 CFR 204, which places reserve requirements on bank deposits. Finally, the Bank has represented that the funds received, plus accrued interest will be recorded on the Bank's general ledger account and accounted for in the same manner as bank deposits, and will be employed to further the Bank's growth and development through lending in the normal course, or through other legally permissible investments.

A discussion of our legal analysis is set forth below, along with guidance on actions and procedures which we believe are appropriate in order for the product to be offered and administered in a manner which is consistent with safe and sound banking practices.

II. Legal Analysis

National banks are expressly authorized to receive deposits and enter into contracts and have broad authorizations to borrow and otherwise fund their operations. Twelve U.S.C. 24(Seventh), which contains a broad grant of authority to national banks, provides in pertinent part that national banks have the power to exercise —

> all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of ex-

> change, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing and circulating notes.

The statutory language and legislative history of § 24 (Seventh) make clear that the business of banking is not confined to the five enumerated powers. The legislative history of § 24(Seventh) supports a broad reading of the business of banking. See Letter No. 494 (December 20, 1989) reprinted in [1989 - 1990 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 83,083 for a full discussion of the statute's legislative history and case law interpretations concerning the scope of the statute. In addition to the authorization to engage in the business of banking set forth in § 24(Seventh), national banks are expressly authorized to enter into contracts under 12 U.S.C. 24(Third).[2]

In construing the nature and scope of permissible banking activities, it is instructive to note that Congress has indicated banks must be afforded flexible alternatives to fund their operations. This belief is implicit in the 1982 repeal of 12 U.S.C. 82, which is used to limit national bank borrowings.[3] The legislative history of the repeal evidences a clear recognition on the part of Congress that to remain competitive, national banks must be able to fund their operations without unwarranted restraints.

> Statutory limitations on the liabilities of national banks have remained essentially unchanged since original enactment of the National Bank Act in 1864. Since that time, however, the nature of the banking business — especially the manner in which banks are

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[2] The United States Supreme Court has confirmed their authority to borrow money. *Wyman* v. *Wallace*, 201 U.S. 230, 243 (1906).

[3] Pub. L. 97-320, Title IV, § 402, Oct. 15, 1982, 96 STAT. 1510.

> funded — has altered considerably. The rigid limitations of § 82 adversely restrain bank flexibility and competitively disadvantage national banks. Many states have no such statutory restraints upon state-chartered institutions.

Senate Rep. No. 97-536, P.L. 97-320, 96 Stat. 1469 (1982), at 60.

In the instant case, the express authorizations for the Bank to receive deposits and enter into contracts, coupled with its powers to incur liabilities and fund its operations, clearly make the Retirement CD an authorized Bank activity. The inherent relationship that the Retirement CD customer has with the Bank is that of depositor or creditor. The customer places funds with the Bank and in turn receives the Bank's promise to repay the amount it has received, plus interest. This promise forms the very basis of the depositor or creditor/bank relationship.

The fact that the product is structured to provide for interest payments keyed in part to the expected life of the depositor does not change the intrinsic nature of the Retirement CD as an authorized bank product. Modernizing bank practices to comport with ever changing customer needs is permissible, provided that the practices remain fundamentally what is authorized by the Act. In addition, utilizing creative funding techniques is a desirable, indeed necessary action for national banks.

In *M&M Leasing Corporation* v. *Seattle First National Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) ("*M&M Leasing*"), the court addressed the issue of whether a national bank may engage in the leasing of motor vehicles. The court concluded that leasing in effect constitutes a loan of money secured by the leased property and is therefore incidental to the "loaning of money on personal security" which is the fourth express power provided in § 24(Seventh). In

reaching its conclusion, the court drew comfort from the fact that "commentators uniformly have recognized that the [Act] did not freeze the practices of national banks in their nineteenth century forms," and added "we believe the powers of national banks in their nineteenth century forms," and added "we believe the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking." *Id.* at 1382.

Similarly, in *American Insurance Association* v. *Clarke*, 656 F. Supp. 404 (D.D.C. 1987) aff'd, 865 F.2d 278 (D.C. Cir. 1988) ("*AMBAC*") the court upheld the Comptroller's determination that a national bank's issuance of standby credit in the form of municipal bond insurance was the "functional equivalent" of the issuance of a letter of credit, which is a permissible banking activity under Section 24(Seventh). The court strongly endorsed the OCC's position that in determining whether the activity in question constitutes part of the business of banking, the Comptroller may "look beyond the label given a certain activity to determine whether or not it is permissible." 656 F. Supp. at 408. Although neither letters of credit nor municipal bond insurance are specifically enumerated as permissible bank products under the Act, the court recognized that extending credit is a fundamental banking practice that can take a variety of forms, regardless of the label given the activity. The court emphasized that the bank powers analysis should focus on the substance of the transaction in question and not proceed "from a narrow and artificially rigid view of both the business of banking and the statute that governs that business." *Id.* at 408.

A national bank's express powers allow it to design products which augment its traditional bank activities. For example, in *Securities Industry Association* v. *Clarke*, 885 F.2d 1034 (2d Cir. 1989), *cert. denied*, 110 S.Ct. 1113 (1990) ("*SIA* v. *Clarke*"), a national bank was

permitted to sell "pass-through" certificates on the basis that this activity is authorized by the Act because it is "convenient and useful" in connection with the bank's sale of mortgage loans. Unlike in *M&M Leasing*, *AMBAC* and *SIA* v. *Clarke*, however it is not necessary to view the Retirement CD as a product which is "incidental," or "useful" to the Bank or a "functional equivalent" used by the Bank in carrying out the business of banking. The product represents the very essence of banking which is embodied in a bank's express authority to accept deposits and enter into contracts, and authority to incur liabilities and fund its operations.

The instant case is quite distinguishable from *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427 (1st Cir. 1972) ("*Arnold Tours*") where the court held that a bank should not be permitted to conduct a travel agency business as part of the business of banking.[4] The key to the *Arnold Tours* ruling was the inability of the court to find that the rendering of travel agency services was "germane to the financial operations of the bank in the exercise of its express powers." *Id.* at 433.

A recent decision of the Fifth Circuit Court of Appeals suggests in dicta a narrow interpretation of the "incidental powers" clause, restricting banks to activities "necessary" to carry out the business of banking. *Variable*

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[4] *Arnold Tours* is the leading case in a line of decisions which have concluded that § 24 (Seventh) grants only five expressly enumerated powers and such incidental powers as are "convenient or useful" for performing those five powers. Taken literally, the wording of this test seems to follow a narrow view of the bank powers clause, however, closer review of these cases shows that the reasoning followed is consistent with the historical, broad interpretation of the business of banking. The OCC has rejected a narrow view of the business of banking. For a full discussion of Arnold Tours and the OCC's position on the case, see, OCC Letter No. 494 (December 20, 1989) reprinted in [1989-1990 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 83,083.

Annuity Life Ins. Co. v. *Clarke*, 998 F.2d 1295 (5th Cir. 1993); *reh'g denied*, 13 F.3d 833 (5th Cir. 1994); petition for cert. filed, April 13, 1994 ("*VALIC*"). In our view, this interpretation is seriously flawed. An overriding failing of the opinion was the lack of appropriate deference accorded the views of the agency responsible for interpreting this statute in accordance with *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Moreover, the standard articulated in the *VALIC* opinion is contrary to longstanding, well established precedent finding that banks may engage in a far broader range of banking activities that resemble or relate to traditional banking activities so that banks may engage in new forms of conducting the business of banking activities so that banks may engage in new forms of conducting the business of banking in response to changing markets and technologies. See generally, OCC Letter No. 494 (December 20, 1989) reprinted in [1989-1990 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 83,083. The *VALIC* standard would severely curtail needed and appropriate banking services and may be subject to further review. Notwithstanding the foregoing, we view the instant case as the exercise by the Bank of its express authorizations to receive deposits and enter into contracts, coupled with its powers to incur liabilities and fund its operations.

The Retirement CD is clearly a financial product whose primary attributes are grounded in the Bank's expressly authorized powers. While somewhat novel in its approach to determining interest on deposits funds by providing customers, inter alia, with fixed periodic lifetime payment, the Retirement CD nonetheless represents fundamentally a bank authorized product. In recent years, national banks have responded to changing customer needs and market forces by offering a range of innovative bank deposit related instruments. Some deposit instruments have had interest rates tied to various indices such as college tuition costs or stock

market performance. In OCC Dec. No. 87-1093, the Comptroller permitted the Chase Manhattan Bank and its affiliate banks to offer a new, non-transferable time deposit account known as the Market Index Investment Deposit Account ("MII"). The MII pays interest at a rate based in part upon changes in the Standard & Poor's 500 Composite Stock Index.[5] The OCC noted that Chase has the express power to offer the MII, and "to pay interest on time deposits according to market conditions, in order to remain competitive with savings alternatives such as money market mutual funds ... based on any index or standard selected by the bank." *Id.* at 4. The decision also approved Chase's purchase of stock index futures to reduce, or "hedge," its interest rate exposure. On this latter issue the OCC noted that hedging its exposure —

> is an integral adjunct to the bank's deposit-taking activity and is incidental to this power and the business of banking under 12 U.S.C. 24(Seventh). The "incidental powers" clause of this section has been flexibly construed by the courts and the OCC in recognition of the fact that the business of banking is continually changing and evolving.[6]

Like the "college-CD" and "Chase indexed CD" which are deposit products intentionally structured to meet specific customer funding needs, the Retirement CD is structured to provide customers with a return on their deposit to meet retirement needs. This structure remains consistent with the express powers of banks to act

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[5] On April 21, 1987, the Investment Company Institute brought suit in the U.S. District Court for the District of Columbia against Chase and the OCC seeking to enjoin the bank from offering the MII and directing the OCC to withdraw its approval. The ICI claimed that the MII violated the Glass-Steagall Act, 12 U.S.C. 24(Seventh), 377, 278 and 78, and the Financial Institutions Supervisory Act, 12 U.S.C. 1818(b)(1982) (Civil Action No. 87-1093, D.D.C.). The case is still pending.

[6] *Id.* at 4.

as deposit takers and to enter into contracts, and with its authorizations to fund its operations and incur liabilities. The creation of new instruments and services under express or incidental banking powers has been permitted over and over again by the OCC.[7] Moreover, adjustments and refinements of core bank products — designed to accommodate the needs of Bank customers — are clearly permissible as incidental to the business of banking. *Id.*

Over the life of the Retirement CD, the depositor will receive a return of the deposit, plus interest. The timing of these receipts calls for up to two-thirds of the maturity balance to be distributed to the depositor at maturity, leaving the remainder as an undistributed maturity balance. The undistributed maturity balance plus an interest factor calculated on the maturity date, is disbursed in the form of lifetime periodic amounts. Should the depositor continue to live after he has received a return of the maturity balance through the periodic amounts, he will continue to receive distributions. These additional distributions represent nothing more than additional interest paid over the life of the Retirement CD. Viewed properly as a single financial product over the full life of the Retirement CD, from initial deposit until final periodic lifetime payment, the total return on the deposited amounts is represented by the

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[7] See, *e.g.*, OCC Letter No. 331 (April 4, 1985), reprinted in FED. BANKING L. REP. (CCH) ¶ 85,501 (variable annuities); OCC Letter No. 271 (September 21, 1983), reprinted in FED. BANKING L. REP. (CCH) ¶ 85,435 (real estate loans and equity interests); OCC Letter No. 387 (June 22, 1987) reprinted in FED. BANKING L. REP. (CCH) ¶ 85,611 (real estate loans); OCC Letter No. 326 (January 17, 1985), reprinted in FED. BANKING L. REP. (CCH) ¶ 85,498 (options); OCC Letter No. 356 (January 7, 1986), reprinted in FED. BANKING L. REP. (CCH) ¶ 85,526 (agricultural and metal futures used for hedging); OCC Letter No. 357 (February 26, 1986), reprinted in FED. BANKING L. REP. (CCH) ¶ 85,527 options on financial instruments and on financial futures); OCC Letter No. 365 (August 1, 1986), reprinted in FED. BANKING L. REP. (CCH) ¶ 85,535 (financial futures).

sum of (i) interest accrued until maturity (ii) the portion of the periodic amounts which is allocable to interest, plus (iii) those periodic amounts, if any, that are received by the depositor after he has received a return of the maturity balance.

The Retirement CD also contains attributes of a bank liability utilized in the ordinary course of the Bank's business to fund its operations. The form of the liability is a financial instrument sold to a customer which contains the characteristics of an ordinary deposit combined with other permissible financial attributes. The timing and calculation of the market return is based in part on the life expectancy of the customer, as calculated at the product's maturity. Simply stated, as with any financial liability, the Retirement CD involves no more than the receipt of customer funds by the Bank in exchange for the payment of a market return to the customer. This flexible form of financing is within the Bank's authorized power to fund its activities through borrowings.

The Bank's Retirement CD simply allows the Bank to offer to its customers, in combination with its other banking related products, the traditional financial advantages normally associated with the business of banking. The product offers Bank customers the opportunity to obtain a return on their funds, structured to accommodate their retirement needs. Market restraints will require that the rate of return on the Retirement CD, when considered in light of the payout structure, is competitive with the market rates of return for other similar financial products, such as traditional bank deposit accounts, bank borrowings, and bank securities offerings. The Retirement CD is a logical outgrowth of the Bank's business mandate which, as with any bank, is to offer its customers competitive and innovative financial products. Through the product, the Bank will be able potentially to reach additional customers and offer current customers an enhanced array of bank products.

The Retirement CD is a natural response to customer demands that their banks offer more diversified alternatives from which they may choose to place their funds. As noted above, bank deposit products already exist to help customers fund college tuition costs and obtain returns competitive with the stock market. Much like the proliferation of IRA accounts and other related deferred compensation products, the Retirement CD is merely a reaction by the Bank as part of its business to create a specially structured bank product intended to meet customer financial needs, with an emphasis on those related to retirement.

Whether the product is characterized as a deposit account, financial contract, bank borrowing or other type of bank product, it remains a financial product which may be offered by the Bank as part of the business of banking. Simply combining activities that fall under the Bank's express and other authority does not affect the underlying ability of the Bank to engage in these activities. In summary, the OCC finds offering the Retirement CD to be authorized under the express powers granted the Bank to receive deposits and enter into contracts, coupled with its powers to incur liabilities, and fund its operations in conducting the business of banking.

III. Conditions

The OCC has no objection to the Bank proceeding with its plans to market and offer the Retirement CD, provided that the Bank complies with the following conditions requisite to the safe and sound operation of this program.

1. The Bank should take appropriate steps to deal with the risks it will undertake in connection with the Retirement CD. In particular, we note that the Bank assumes the risk of paying interest throughout the life of each depositor even in situations where the maturity

balance becomes exhausted. The Bank's business plan should indicate in detail how it plans to mitigate this risk as well as the other risks, and consideration should be given to purchasing commercially available annuities from insurance companies to fund the Bank's payment obligations.

2. The Bank should plan for the impact that fluctuations in interest rates will have on its interest rate spread. We note that the product contains an initial fixed rate period of from one to five years, after which the interest rate can be adjusted in accordance with the Bank's cost of funds, but not below a floor of 3 percent. A significant decline in interest rates could reduce or eliminate any spread between the interest rate payable on this product and the interest received on corresponding assets.

3. The Bank must adequately manage its funding sources for the Retirement CD, considering the financial risks associated with the product. The Bank should avoid inadequate matching of funding sources which could result in the unplanned sale of investments in managing interest rate or liquidity risk. This could result in the reclassification of investments as held for sale, the required use of market value accounting and a concomitant decrease in the Bank's capital.

4. The Bank's board of directors should take steps to assure that appropriate accounting standards are followed. Selection of an accounting firm with substantial expertise in the accounting issues associated with the product will be particularly important. We note that the need for specialized accounting expertise has been recognized in the past by the Bank in situations where it has utilized the services of a major accounting firm for specialized reviews.

5. The design and implementation of adequate product controls and systems will be necessary to enable

the Bank to mitigate the risks associated with the product. In particular, we note the importance of adequate planning for the use of funds generated from the product; accurate estimation of product payouts; and proper design of internal controls.

6. The Bank should take all necessary steps to assure that representations to customers concerning the FDIC insured status of the Retirement CD are fair and accurate, and that any limitations on the insurance status of the product are conspicuously indicated. In this regard, the Bank should obtain an opinion from the FDIC that it will treat the Retirement CD as an insured product before representing that this product is so insured.

7. We call your attention to the Interagency Statement on Retail Sales of Nondeposit Investment products, NR 94-21 (February 17, 1994), which contains guidelines for insured depository institutions engaged in the sale of nondeposit investment products, including mutual funds and annuities. In the event the FDIC determines that all or a portion of the Retirement CD is not covered by FDIC insurance, the guidance provided in the Interagency Statement with regard to nondeposit investment products should be followed in structuring suitable Bank policies and procedures with respect to the manner in which the product is offered and sold to customers.

8. Use of the term "guaranteed" as applied to the Retirement CD may be misleading, and may cause customers to confuse the "guarantee" with FDIC insurance. Some phrases as are currently included in the Bank's promotional materials, such as "bank guaranteed monthly payments for life" may be misconstrued by the public as a FDIC guarantee, especially when the term "guarantee" precedes or follows statements about FDIC insurance. In addition, the claim that the CD is "guaranteed" by the Bank is redundant since the Bank is the obligor on the instrument meaning, that the Bank's guaranteed does not accord the customer any further

rights or impose on the Bank any additional obligations. Thus, we strongly urge against use of the term "guaranteed" in promotional materials.

9. The Bank should carefully review representations it plans to make concerning the tax treatment of the Retirement CD to customers. In the event the Bank plans to proceed without obtaining a revenue ruling from the Internal Revenue Service, it should assure its disclosure materials fully inform customers of the risks associated with the Bank's tax position. The distinction between an opinion of counsel and a revenue ruling should also be clearly disclosed.

10. If an early withdrawal by a customer will result in a substantial negative tax impact, this information should be prominently displayed in the Bank's promotional materials. In addition, the promotional materials should contain a full explanation of the tax impact a prepayment could have if forced on customers by the FDIC acting as receiver or conservator for the Bank and if customers elect not to utilize a rollover option.

11. We note the applicability of the requirements imposed by 12 U.S.C. 4301 et seq. and 12 CFR 230 et seq. ("Truth in Savings") which mandate among other elements, disclosure that the product's interest rate and annual percentage yield ("APY") may change; the method used to determine the interest rate; the frequency with which the interest rate may change; and limits, if any on the amount the interest rate may change. 12 CFR 230.4(b)(1)(ii). Additional disclosures are required concerning the penalty for early withdrawal, including that a penalty will or may be imposed for early withdrawal, how it is calculated, and the conditions for its assessment. 12 CFR 230.4(b)(6)(ii). We note that the cover letter in the draft promotional materials includes a statement that there are substantial penalties for early withdrawal, as well as a reference to a more detailed explanation of the penalties elsewhere in the materials.

However, we believe that the disclosure of the existence of these penalties should be more prominently displayed.

12. As a result of the inherent complexities present with the product, we are particularly concerned that the Bank clearly disclose to prospective and actual customers the product's mechanics and economics. In particular, the promotional materials should clearly explain the way in which the refund feature is calculated. The materials should specifically note that if a depositor dies before receiving distributions equal to the maturity balance, the depositor and his beneficiaries will receive the difference between the maturity balance and the payments received to date. In effect, if this happens, the depositor will not receive any interest on the maturity balance during the payment phase. The impact of this feature we believe is significant enough to warrant conspicuous disclosure on the cover page of the promotional materials. We believe additional disclosures should clearly explain that the periodic lifetime payment amount will be computed on maturity, and will remain fixed throughout the remainder of the customer's life; that the amount in the customer's account at maturity is the dollar amount used for computing the amount of periodic withdrawals; and the manner in which the periodic amounts are determined including how the applicable interest rate is selected.

13. A significant risk associated with the Retirement CD stems from the fact that once the fixed interest rate period expires, the Bank may, in accordance with its cost of funds, adjust the interest rate (but not below the minimum rate) as often as it wishes. This feature of the product may be especially susceptible to confusion on the part of depositors familiar with traditional deposit products. The Bank should take appropriate steps to ensure that customers understand this feature. The risks associated with this feature are significant enough to

justify disclosure on the cover page of the promotional materials and elsewhere as appropriate.

14. We note that the Bank expects that most if not all deposits taken under the Retirement CD will come through the mail from depositors located throughout the U.S.A. However, to the extent the Bank engages in sales on its premises, we believe that the unique features of this product requiring disclosure would make it unsuitable for sales in the routine deposit-taking area, such as the teller window. The Bank should arrange for customers to be referred to individuals who are specifically designated and trained to assist customers interested in making a deposit under the Retirement CD. This approach would enable the Bank to ensure that customer questions are answered by personnel who are well-acquainted with the complexities associated with this product.

15. The Bank should implement an appropriate training program for personnel who will be involved in marketing the Retirement CD. The program could be structured to ensure a thorough understanding of the product so that customer questions can be answered properly, and investment risks conveyed adequately.

16. The Bank's training and compensation systems for the product should include safeguards that encourage employees to recommend the Retirement CD only in situations where there are reasonable grounds for believing that the CD is suitable for the particular customer on the basis of information disclosed by the customer. Before making recommendations, employees should make reasonable efforts to obtain tax status, investment objectives, and other information that may be useful, reasonable or necessary to enable the employee to conclude whether the CD is suitable for that customer.

17. The Bank should develop and implement policies and procedures to ensure that its marketing efforts

associated with the Retirement CD are in compliance with applicable laws and regulations, safety and soundness, the Bank's internal policies and procedures, and principles set forth in this letter. The Bank should also provide for a system to monitor customer complaints and their resolution.

You have furnished us with a copy of the Licensing Agreement that was entered into between the Bank and American Deposit Corp., on January 14, 1994 (the "Agreement"). We understand that this Agreement grants the Bank a nonexclusive license to market and sell the Retirement CD throughout the world. The license does not include, however, the right to subcontract or sublicense the marketing and sale of the product *e.g.*, to another bank. Please be advised that the OCC takes no position on the ability of American Deposit Corp. to license this product, or on the proprietary nature of the Retirement CD as it pertains to American Deposit Corp. Moreover, we take no position on whether the Bank or any other depository institution could structure its own CD with attributes similar to those of the product without entering into the Agreement.

If you have any questions on the foregoing, or need any additional information, please feel free to contact the undersigned or Eugene H. Cantor, Senior Attorney, at 202-874-5202.

William P. Bowden, Jr. Chief Counsel

APPENDIX D

DETERMINATION OF THE FDIC

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20429

May 12, 1994

American Deposit Corp.
c/o Dennis M. Gingold
Anderson, Aukamp & Gingold
1250 Twenty-Fourth Street, N.W.
Suite 700
Washington, D.C. 20037

Dear Mr. Gingold:

This is in response to your letter of April 19th and our meeting of April 26, 1994 concerning the "Retirement CD," a new product which has been developed by American Deposit Corp. ("ADC"). The Retirement CD combines features of a traditional certificate of deposit together with certain payment terms and tax advantages of an annuity contract. Initially, the Retirement CD is being offered by a single bank, Blackfeet National Bank of Browning, Montana, under a licensing agreement with American Deposit Corp. However, if the product is successful, it may be licensed to other FDIC insured depository institutions.

Your letter, as well as certain news reports, raise the question of whether the Retirement CD product is a deposit entitled to FDIC insurance and, if so, the extent of such insurance. The Office of the Comptroller of the Currency has also asked us to look into the insurability of this product. Toward this end, we have reviewed the promotional information, Account Terms and Conditions, Account Request Form, and other pertinent information concerning the product offering which you provided

with your letter and during our meeting, along with an advertisement placed by Blackfeet in the February 15, 1994 Wall Street Journal.

It is our understanding that Blackfeet's Retirement CD would function along the following lines. Customers may open a Retirement CD account with a minimum initial deposit of $5,000. Subsequent deposits of not less than $1,000 may be made once a year. When the account is opened, the customer chooses a date ("Maturity Date") when the CD will mature, but the minimum term of the account must be at least one year. Upon opening the account, the customer also chooses his/her payout options. Customers may choose to receive up to two-thirds of the account balance (principal plus accrued interest) in a lump sum at maturity. Any amount which the customer elects not to receive in a lump sum at maturity will be used as the basis for the calculation of equal monthly payments which will be made for the remainder of the customer's life (or, in the case of a joint account, the survivor's life). Customers may change their payout option at any time up to thirty days prior to the Maturity Date. Unscheduled withdrawals prior to the Maturity Date will incur substantial penalties, unless they are due to the death or disability of the customer. Shortly after opening the account, customers will be mailed a "certificate of deposit." It is our understanding that the bank will record these funds on the bank's books as deposit liabilities, pay deposit insurance assessments on them, and use them in the normal course of its business. Insofar as the Retirement CD is being characterized as an annuity for income tax purposes, income taxes reportedly are deferred until the time of withdrawal. The period of time from the customer's purchase of the Retirement CD up until the Maturity Date is referred to as the accumulation phase. The period of time after the Maturity Date is referred to as the payout phase.

Due to the tax features of this account, it is reasonable to expect that many, if not most, customers will choose a Maturity Date which coincides with their retirement. The Retirement CD pays a fixed rate of interest for up to the first five years, after which time the interest rate is adjusted at the bank's sole discretion without reference to any independent index. However, the issuing bank contracts that the interest rate will never fall below three per cent per year. Interest ceases being posted to the customer's account upon maturity. However, the bank utilizes an "imputed interest rate" during the payout phase to calculate the monthly benefit which the customer will receive. If the account owner dies prior to the Maturity Date, his/her beneficiary will receive the principal and all accumulated interest. If the account owner dies after the Maturity Date, the beneficiary will receive the principal and all accumulated interest up until the Maturity Date, less any lump sum distribution and monthly payments which have been made. The bank will charge a one time set-up fee of $100 when the account is opened.

Interest (in the traditional sense) ceases being posted to the customer's account at maturity, while the bank utilizes an "imputed interest rate" during the payout phase. Thus, the value of a customer's account after the Maturity Date which is payable to a beneficiary upon the customer's death would be equal to all principal plus accrued interest earned up until maturity minus any lump sum distribution and monthly benefit payments. However, the "expected value" of the monthly benefit payments which the bank has contracted to make would generally be greater than the amount payable to a beneficiary because of the imputed interest which the bank uses to calculate the expected monthly benefit stream.

In reviewing the Retirement CD, the FDIC has considered (1) whether the Retirement CD is a deposit, as that term is defined in section 3(1) of the Federal Deposit

Insurance Act ("FDI Act"), 12 U.S.C. 1813(1); (2) if so, the extent to which the Retirement CD is covered by FDIC deposit insurance; and (3) the adequacy of disclosures to customers made in the issuing bank's promotional materials and advertisements concerning the extent of FDIC insurance.

Section 3(1) of the FDI Act, in relevant part, defines a "deposit" as:

> "the unpaid balance of money or its equivalent received or held by a bank ... in the usual course of business and for which it is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by a certificate of deposit... ."

12 U.S.C. 1813(1). Not all liabilities of a bank are deposits for the purposes of the FDI Act. Whether a particular liability comes within the definition is a question that turns upon all of the facts and the intent of the parties.

The first requirement is that there must be an "unpaid balance of money or its equivalent." For example, if a bank is holding real estate or some other non-monetary asset, this requirement would not be satisfied. In the case of a Retirement CD, however, the bank's obligation will be funded with cash or an instrument ordering the transfer of cash funds and thus the CD clearly represents "the unpaid balance of money or its equivalent."

Second, customer funds used to purchase Retirement CDs apparently will be received and held by the bank in the usual course of its business. There is no indication that the funds will be received or held by a holding company, any subsidiary or affiliate of the bank, or by any unrelated party. The bank intends to solicit the funds from retail customers, as it solicits other types of deposits.

Third, in this case, the bank will be giving credit for the funds received to an account established for the customer which will be evidenced by a "certificate of deposit," which the bank has indicated it would issue to each customer. Although the customer may have limited rights to withdraw the funds, the bank will nonetheless be obligated to repay all principal and interest accrued up to the Maturity Date to the customer (or if the customer dies prior to full repayment, to his estate or designated beneficiary).[1]

In addition, in order for there to be a "deposit" the parties generally have to intend to create a deposit liability. In most cases, the parties evidence their intent by including language in the pertinent agreements indicating whether or not a particular liability of the bank is intended to be a deposit liability as opposed to some other type of general obligation of the bank. If the parties intend to create a non-deposit liability, such as a bank note or other subordinated liability, then generally a deposit is not created (although the intent of the parties is not always determinative since it is only one factor that is considered).

Based on the foregoing and subject to the limitations discussed in the succeeding paragraph, we have concluded that the Retirement CD is a "deposit," within the meaning of section 3(1) of the FDI Act, because: (1) there is an unpaid balance of money or its equivalent received and held by the bank in the usual course of business; (2) the bank will utilize the funds received in

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[1] Once a retirement CD matures, the customer does not have the option of receiving all principal and interest in one lump sum. At the minimum, one-third of the account balance can only be paid to the customer in monthly installments over the remainder of the customer's life, similar to an annuity. Thus, the CD appears to be a hybrid. It possesses certain features which are characteristic of a deposit, while other features resemble an annuity.

the normal course of its banking business (*e.g.* to make loans or investments); (3) the bank will give credit for the funds received to an account evidenced by a certificate of deposit; (4) the parties intend to create a deposit liability, as evidenced by language expressing such intent in the Account Terms and Conditions, Account Request Form and other promotional material provided to us; (5) in the event of the account holder's death, the bank will pay an amount equal to all remaining principal and interest in the account to the customer's beneficiary; and (6) we understand that the bank intends to treat the Retirement CD like any other deposit liability, including booking it as a deposit for accounting purposes, paying deposit insurance assessments on it and maintaining the necessary reserves pursuant to regulations promulgated by the Board of Governors of the Federal Reserve System.

With regard to the extent of FDIC insurance, we have concluded that a Retirement CD will be insured for the same amount (up to a maximum of $100,000) that would be payable to an account holder's beneficiary in the event of the account holder's death. That is, in the event the issuing bank were to fail prior to the Maturity Date, a Retirement CD would be insured to the same extent as any other type of CD, *i.e.*, for principal and accrued interest up to the date of failure. In the event that the bank were to fail after the Maturity Date, the FDIC would pay a customer the balance of the account at the Maturity Date (principal plus accrued interest) minus any lump sum distribution and any monthly payments, up to a maximum of $100,000. We also point out that a Retirement CD would not be insured separately from any other individual or joint accounts, as the case may be, which the depositor(s) may maintain at the same insured depository institution. *Under no circumstances would FDIC insurance extend to the bank's commitment to make lifetime payments, as the value of such payments is uncertain and may exceed the total*

account balance.[2] The FDIC is aware that the insured amount would generally be less than the expected value of the monthly payments which the bank agrees to make. However, as we noted previously, the FDI Act § 3(1) definition of "deposit" contemplates a sum of money being held by the bank on behalf of a depositor for which the bank is obligated to give credit. The expected value of the contractually agreed-to monthly payments does not reflect an account balance, *i.e.*, principal deposited by the customer plus accrued interest posted to the customer's account. Instead, the expected value (which you have represented as being an ascertainable number) is derived from the total value of the expected monthly payments. However, it is not reflected in any account statement which is made available to the customer. In fact, subsequent to the Maturity Date, the bank no longer produces Retirement CD account statements. From that point in time on, the customer receives only his/her monthly check and a IRS Form 1099R.

You should be aware that the manner in which an insured depository institution advertises its deposits is subject to the proscriptions of Federal Reserve Board Regulation DD, Truth in Savings, 12 CFR Part 230, and section 709 of the United States criminal code, 18 U.S.C. 709. More specifically, section 230.8(a) of Regulation DD provides that "[a]n advertisement shall not be misleading or inaccurate and shall not misrepresent a depository institution's deposit contract." 12 CFR § 230.8(a).[3] 18

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[2] We note that the FDIC's conclusion with regard to the extent of deposit insurance to be afforded a Retirement CD is in accord with a written legal opinion you provided to us issued by a private law firm at your request.

[3] Section 230.8 also prescribes specific disclosures in advertisements which solicit deposits concerning the terms and rates that are being offered.

U.S.C. 709, a criminal statute, provides that it shall be unlawful for anyone to "falsely [advertise] or otherwise [represent] by any device whatsoever the extent to which or the manner in which the deposit liabilities of an insured bank or banks are insured by the Federal Deposit Insurance Corporation... ."

The FDIC is extremely concerned that customers understand what is and is not covered by FDIC insurance. A recent survey has shown that many customers who purchase mutual funds on bank premises are under the erroneous impression that those investments are insured by the FDIC. The federal financial institution regulatory agencies' concern about depositors understanding exactly what is and is not insured is reflected in the recently issued "Interagency Statement On Retail Sales Of Nondeposit Investment Products."

The FDIC therefore strongly believes that all promotional materials, advertisements, agreements and other customer materials concerning the Retirement CD should clearly and conspicuously state that the lifetime monthly annuity payments are not *guaranteed* by the FDIC. The bank should also exercise care that the relative size of typefaces used in promotional materials as well as the juxtaposition of statements could not, in any way, be reasonably expected to create a deceptive and/or misleading impression.

The FDIC has examined the Retirement CD promotional materials, Account Terms and Conditions and Account Request Form, you provided to us. The FDIC is concerned that consumers who may choose to open such an account with the bank may be mislead with regard to the extent of FDIC insurance for such an account. For example, the bank's sample cover letter to a prospective depositor states that "[o]nce your account matures, you are guaranteed by the bank to receive a monthly payment for the remainder of your life." (Emphasis in original). One sentence later, that paragraph continues

by stating "Please note, FDIC insurance relates only to the account balance and accrued interest." Shortly thereafter, however, the letter asserts that "[i]f you are looking for ... a guaranteed return and federal insurance ... then you should seriously consider a Retirement CD." (Emphasis in original). We remain concerned that the proviso concerning the extent of FDIC insurance is inaccurate and that the juxtaposition of these two statements could mislead a consumer. We suggest that the proviso be revised to read "Please note, FDIC insurance relates only to the principal (the amount you contributed) plus interest accrued to maturity."

Similarly, the bank's one-page fact sheet states that "Blackfeet's Retirement CD is the first and *only* retirement account to combine lifetime benefits, long-term tax-deferral, FDIC insurance and flexibility." It also states that "FDIC insurance makes the Retirement CD as safe as your savings account... ." The bold-face caption immediately above this statement reads "Federally insured up to $100,000." The paragraph immediately below this one is captioned "Your payments are guaranteed for life." The paragraph states that "[o]nce your account reaches maturity, the bank guarantees monthly payments for the rest of your life." In this case, the bank is analogizing its Retirement CD to a simple savings account in terms of safety. Such is not the case. A customer's savings account is fully insured by the FDIC up to a maximum of $100,000 such that if the bank were to fail that customer would receive the full value of the customer's account (principal plus accrued interest) up to the $100,000 maximum. However, in the case of a Retirement CD, if the bank were to fail after the Maturity Date and at a point in time where the customer had already been paid the full value of the account through a lump sum distribution and monthly payments, the FDIC would neither insure nor continue to pay those monthly payments for the rest of the customer's life. Once again, we are concerned that the above-noted

representations may be misleading. The bank's February 15, 1994 advertisement in the Wall Street Journal raises similar concerns to those expressed above. Any time the bank chooses to stress FDIC insurance and guaranteed payments for life, consumers can reasonably be expected to assume that FDIC insurance covers the lifetime monthly payments.

The FDIC is also concerned about Blackfeet's explanation of deposit insurance in the Account Terms and Conditions. The text states that "[t]he deposits of each depositor are insured by the Federal Deposit Insurance Corporation for up to an aggregate amount of one hundred thousand dollars ($100,000)." However, once again, this document does not make it clear to customers that under no circumstances will the FDIC be responsible for continuing to pay monthly benefits during the payout phase. This section of the Account Terms and Conditions goes on to state that "[f]or insurance purposes, jointly owned accounts are considered to be held by one depositor." We consider this statement to be misleading. Pursuant to § 330.7 of the Corporation's deposit insurance rules and regulations (12 CFR § 330.7), joint accounts are aggregated with other joint accounts and insured separately from individual accounts.

Section 230.8(c) of Regulation DD provides that if an annual percentage yield is stated in an advertisement for a time deposit, the advertisement shall clearly and conspicuously include a statement that a penalty will or may be imposed for early withdrawal. We note that the bank's one page fact sheet which states the annual percentage yield for a three and five year initial term Retirement CD at the bottom includes no such required disclosure. The FDIC is concerned that potential customers be made aware of the substantial penalties for early withdrawal from a Retirement CD in circumstances other than death and disability.

We also call your attention to the aforementioned "Interagency Statement on Retail Sales of Nondeposit Investment Products" which sets forth guidelines that insured depository institutions should follow when selling nondeposit investment products, such as mutual funds and annuities, to retail customers. While we have concluded that the Retirement CD is an insured deposit, with some limitations, it nonetheless also possesses certain characteristics which make it quite similar to an annuity. We think that some of the same concerns discussed in the Interagency Statement with regard to nondeposit investment products may be applicable to the Retirement CD.

Insured depository institutions offering the Retirement CD product should also keep in mind that the FDIC's brokered deposit regulation (12 CFR § 337.6) may be applicable under certain circumstances.

We are unable to comment concerning the question of how a Retirement CD would be treated in a bank failure that is resolved via the use of a purchase and assumption transaction. The precise nature of these transactions differs on a case-by-case basis.

Finally, the issue of the safety and soundness of any bank's participation in offering the Retirement CD will be subject to review by the appropriate regulators and the FDIC as back-up supervisor. The FDIC may have substantive concerns with regard to how a bank manages funds received in this program. Where the issuing bank is an insured state nonmember bank and thus within the FDIC's supervisory jurisdiction, these issues should be discussed with the FDIC's Division of Supervision. The FDIC's Legal Division takes no position with regard to any safety and soundness concerns which may be raised by the Retirement CD product. Similarly, the Legal Division is not expressing any opinion with regard to the tax status of the Retirement CD. Our opinion relates solely to the insured status of the Retirement CD and is

based upon the facts as we understand them as outlined above. Different facts or circumstances may alter our opinion.

Our willingness to respond to your request for an opinion as to the insurability of the Retirement CD product should in no way be represented or construed as an endorsement or approval by the FDIC of the product. To the contrary, the FDIC expressly disclaims any such endorsement or approval.

If you have any questions concerning this letter, please feel free to contact Claude A. Rollin, Senior Counsel, or Jeffrey M. Kopchik, Counsel, at (202) 898-3985 or (202) 898-3872, respectively.

Very truly yours,

Douglas H. Jones
Acting General Counsel

cc: Jack Kelly, President
Blackfeet National Bank

APPENDIX E

EXCERPTS FROM THE McCARRAN-FERGUSON ACT 15 U.S.C. §§ 1011 et seq.

§ 1011. **Declaration of policy**

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. **Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948**

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, that after June 30, 1948, [the Sherman, Clayton, and FTC Acts] shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

APPENDIX F

EXCERPTS FROM THE NATIONAL BANK ACT
12 U.S.C. Chapter 2

§ 24. Corporate powers of associations

Upon duly making and filing articles of association and an organization certificate the association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

. . . .

Third. To make contracts.

. . . .

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. . . . .

* * *

§ 484. Limitation on visitorial powers

(a) No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

(b) Notwithstanding subparagraph (A), lawfully authorized State auditors and examiners may, at reasonable times and upon reasonable notice to a bank, review its records solely to ensure compliance with applicable State unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with such laws.

APPENDIX G

EXCERPTS FROM ILLINOIS INSURANCE CODE

Sec. 2. **General definitions.** In this Code, unless the context otherwise requires,

. . . .

(c) "State" or "State of the United States" includes the District of Columbia and a territory or possession of the United States.

(d) "Country" or "Foreign Country" includes a state, province or political subdivision thereof.

. . . .

(f) "Domestic Company" means a company incorporated or organized under the laws of this State. 215 ILCS 5/2 (1995).

(g) "Foreign Company" means a company incorporated or organized under the laws of any state of the United States other than this State.

(h) "Alien Company" means a company incorporated or organized under the laws of any country other than the United States.

* * *

Sec. 4. **Classes of insurance.** Insurance and insurance business shall be classified as follows:

Class 1. **Life, Accident and Health.**

(a) **Life.** Insurance on the lives of persons and every insurance appertaining thereto or connected therewith and granting, purchasing or disposing of annuities. Policies of life or endowment insurance or annuity contracts or contracts supplemental thereto which contain provisions for additional benefits in case of death by accidental means and provisions operating to safeguard such policies or contracts against lapse, to give a special

surrender value, or special benefit, or an annuity, in the event, that the insured or annuitant shall become totally and permanently disabled as defined by the policy or contract, or which contain benefits providing acceleration of life or endowment or annuity benefits in advance of the time they would otherwise be payable, as an indemnity for long term care which is certified or ordered by a physician, including but not limited to, professional nursing care, medical care expenses, custodial nursing care, non-nursing custodial care provided in a nursing home or at a residence of the insured, or which contain benefits providing acceleration of life or endowment or annuity benefits in advance of the time they would otherwise be payable, at any time during the insured's lifetime, as an indemnity for a terminal illness shall be deemed to be policies of life or endowment insurance or annuity contracts within the intent of this clause.

* * *

Sec. 51. **Issuance of certificate of authority.** . . . No company shall transact any business of insurance in this State until it shall have received such certificate of authority as herein prescribed nor any business of insurance not specified in such certificate of authority.

* * *

Sec. 111. **Conditions of issuance of certificate of authority.** (1) Before a certificate of authority to transact business in this State is issued to a foreign or alien company, such company shall satisfy the Director that:

. . . .

(c) if a company transacting business of the kind or kinds enumerated in Class 1 of Section 4, . . . it is not transacting any kinds of business other than those enumerated in Class 1 of Section 4;

. . . .